IMA ASIA

Asia Pacific Executive Brief
August 2016

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Global outlook

Stuck in a world with weak growth

The prospects for a mild global recovery have receded through 2016. Most of the problem appears to lie in advanced markets, with a mild but extended US recovery dropping from a 2.5% pace to around 1.5%, Japan's growth stalled at 0.5%, and a newer but broad-based Euro area recovery capped at around 1.5%. China's steady dwindling in growth hasn't helped. That has led to a continued fall in global trade and in inflation rates, with excess capacity for production and shipping set to continue well into 2017. Notwithstanding China's cooling, a moderate to strong expansion is continuing in emerging Asia, mostly thanks to firm local demand. The challenge for all regions in 2H'16 and 2017 will be finding domestic sources of growth in a low growth world.

The big debates

… shifting views on debt

… & growing concern over pensions

Three related trends will play across the weak global demand outlook. One is the search for yield, as bond prices rise, interesting stocks look over-priced, and company sales growth adjusts to weaker markets. A second trend is a shifting view on debt in governments and households. Households have taken most advantage of this, with a jump in consumer debt over the last few years. Governments are struggling to accept that prolonged cheap debt suggests they should expand budget deficits. Finally, and less positively, low yields on bonds combined with longer life expectancy is a disaster for pensions. Few governments are addressing this, but it is likely to be the next big crisis confronting the world, and it is likely to make US and European voters even more dyspeptic than in the last few years.

The US slows in 2016

… as a slump in capex over-powers mild consumer growth

… so the Fed won't lift its rate in 2H'16

US growth slipped to 1.2%yoy in Q2'16, the slowest pace in three years with the consumer and fixed investment sectors heading in different directions. The main damage was done by a 3.4%yoy fall in private fixed investment that followed a 0.7%yoy fall in Q1'16 – the two weakest consecutive quarters for private capex since the 2008-09 financial crisis. US firms are holding back on new capex, as a mild but long US expansion (now at seven years) looks set to slow. The external trade results capture another aspect of the slowdown, with exports for the year to June down 5.6% and imports down 4.6%. Weakness is also apparent in industrial production (down 1.1% for the year to July) and factory capacity utilisation (at 76% in July). While real growth in consumer spending edged up to 2.7%yoy in Q2'16, faster than the prior three quarters, it was still below the 3%+ rate typical of an expansion. This doesn't present a strong enough case for a lift in the Fed's policy interest rate in 2H'16, even though the Fed has been signalling the potential for a rate rise, and the unemployment rate has been steady at 5% for the three months to July.

The EU

… a broad but mild recovery continues

By contrast, the Euro area, which returned to year-on-year growth at the end of 2013, is continuing with a slow expansion that is trending around 1.5%yoy. On some measures, the Euro area remains in a big hole, with a 10% unemployment rate that is double that of the US. However, its recovery is broad-based, including a 1.5%yoy lift in fixed investment in Q1'16 (Q2 is not yet available) and a 9.3% rise in new passenger car registrations for the year to June. Export factories have also benefited from the Euro holding at around US$1.11 from early 2014, after falling from a high US$1.38 over the prior year. Even though the recovery is weak, the ECB's negative interest rates and quantitative easing appear to have helped nudge local demand up. They've also helped keep the Euro weak, and should prevent a rise when it becomes clear that the US Fed won't lift its interest rate this year.

IMA Asia's forecasts	2013	2014	2015	2016	2017
World – Real GDP growth, %	3.3	3.4	3.1	2.6	2.8
- US	1.5	2.4	2.4	1.6	1.8
- Euro area	-0.3	0.9	1.6	1.2	1.3
- Asia/Pacific (14)	4.5	4.3	4.3	4.3	4.2
- NICs (4)	2.7	3.4	2.1	1.8	2.4
- Developing or "EM" Asia (7)	7.0	6.8	6.6	6.3	5.9
- ASEAN (6)	5.0	4.4	4.4	4.5	4.9
World goods & services trade volume, % growth	3.4	3.5	2.8	2.5	2.7
Interest rates, US Fed target rate, year end, %	0.10	0.10	0.25	0.25	0.50
Inflation, CPI, US, year avg., %	1.5	1.6	0.1	1.2	1.5
Inflation, CPI, Euro area, %	1.3	0.4	0.1	1.0	1.2
Crude oil, avg of 3 spot crudes, US$	104	96	51	45	48
US$ / Euro 1, year average rate	1.33	1.33	1.11	1.10	1.08
Yen / US$1, year average rate	98	106	121	105	97

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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Australia

Political & policy issues to watch

PM Turnbull leads a weak government

PM Turnbull's gamble on a double dissolution election on July 2nd to win control of the senate backfired. His Liberal-led Coalition won a slender one-seat majority in the lower house, leaving him exposed to the demands of his party's right wing conservatives and from restive backbenchers. Meanwhile, the Coalition lost three seats in the senate, so it now requires nine additional votes from the Greens or the 11-person (previously eight-person) crossbench to pass legislation. Both developments will make it harder for pass legislation, and could force Australia to another election before the current three-year term expires.

Little scope for effective reform legislation

The government's early legislative tests include a same-sex marriage plebiscite and amendments to superannuation. The nationalist/racist One Nation Party is the largest bloc on the crossbench (four seats) and is likely use its swing votes to push for policies such as tighter immigration policy and abolition of the renewable energy target. The Nick Xenophon team, the second largest bloc on the Senate crossbench, may try to use its votes to halt any further progress on free-trade agreements.

Outlook for the market

Growth stays near 2.5%

… provided there's a soft landing for housing

Thanks to a mix of sound economic policy and big swings in the exchange rate, Australia has had a remarkable run of 25 years without a recession. However, the sharp drop in global commodity prices has hurt Australian incomes, with net disposable income per capita shrinking for about four years. Helping to offset that slump is a 27% lift in export volumes, as new super mines have come on stream. A four-year housing market boom has also helped, and provided it achieves a soft landing, GDP growth should be sustained at about 2.5% through to 2017, about the same pace as in 2015 and just below the 2.7% average for the decade to 2015.

Capex keeps falling

… as new mine work falls

… and housing cools

Mining investment is expected to drop to a 2% share of GDP in FY 2016/17, having already slid to 5% in 2014/15 from almost 8% in 2012/13. Robust housing activity has helped to offset the mining capex downturn, with home construction surging by 10% in 2015. However, there are signs that the property market may be cooling, with growth in home prices and dwelling approvals softening, suggesting that home construction will grow by 6-7% in 2016. A host of new state taxes on foreign investment in residential property could aggravate the housing downturn. The big fall in mining capex means that total fixed investment is likely to fall 4-5% in 2016 and 1-2% in 2017, after a 4% fall in 2015.

Migration and debt lift demand from consumers

The sharp fall in global commodity prices has resulted in a steep drop in Australian incomes, with wage growth slumping to a record low of 2.1%yoy in H1'16. Despite that, population growth of 1.4%pa and rising household debt should keep growth in real consumer spending at 2.5-3.0%pa in the next two years, close to its 2015 pace. Longer-term, high household debt equal to 125% of GDP is a concern. Yet, with interest rates at record lows, interest payments have dropped to 8.7% of disposable incomes from 11.4% in 2011. Interest rates are likely to stay low for some time and that should help to contain risks.

Services drives growth

Services account for about 58% of GDP, and the sector's strength has helped to cushion the downturn in the mining sector. In 2015, the services sector accounted for 79% of GDP growth, and some 97% of the jobs created since commodity prices peaked in 2011. However, as housing cools, services output should slow to 2.5-3.0%pa in the next two years, down from 3.4% growth in 2015.

Watch for a weaker A$ in 2017

The RBA cut its policy interest rate to a new-record low of 1.50% in early August, after consumer price inflation slipped to a 17-year low of 1%yoy in Q2'16. With inflation likely to remain subdued, and the US Fed potentially lifting its policy rate, the interest rate differential that has supported the A$ in 2016 could fade in 2017, bringing a lower A$.

Year ending December 31	2013	2014	2015	2016	2017
GDP, real growth, %	2.0	2.7	2.5	2.5	2.5
CPI, year average, %	2.4	2.5	1.5	1.2	1.6
RBA cash rate, year end, %	2.50	2.50	2.00	1.50	1.50
A$1 = US$, year average	1.03	1.11	1.33	1.35	1.40
US$1 = A$, year average	0.97	0.90	0.75	0.74	0.71

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

New Zealand

Political & policy issues to watch

PM Key skilfully manages minority government

PM Key of the National Party has been in office since 2008, successfully running minority governments with the support of minor parties and independents. The result has been good policy making during the 2008 global financial crisis, the 2010-11 Christchurch earthquakes, and the recent collapse in dairy prices (NZ's largest export). With a current opinion poll approval rating of 47%, the Nationals should win the 2017 election, giving Key a fourth term if he chooses to continue.

The RBNZ's dilemma

… how to cut interest rates

… while curbing a housing boom

It is often said that the NZ economy runs on two engines – the diary sector and housing. Over the last year, strong inward migration and cheap global capital have allowed a housing boom to offset a dairy bust. The challenge for PM Key and the central bank (the RBNZ) has been preventing a housing boom from turning into a bubble, triggering a recession. That has been very tricky for the RBNZ, as tumbling inflation has required interest rate cuts to prevent the NZ$ soaring, which would otherwise have aggravated a collapse in export earnings. That has forced the RBNZ to use non-monetary controls to cool housing. Earlier measures did little, so the RBNZ will lift the minimum deposit requirement for property investors to 40% in September and broaden a 30% deposit requirement that had so far only applied in Auckland. Median home prices hit an all-time-high in July, up 8.6%yoy and 45% from July 2010. A 10%yoy fall in the number of dwelling sales in July, hints that the housing price surge may be ending.

Outlook for the market

Scope to continue with 2-3% growth

… as a dairy recovery offsets a housing downturn

NZ is set to gain from a slow recovery in the dairy sector over the next two years as housing cools, which will keep GDP growth around 2.5% this year and next year. If housing fails to cool – and the current upturn has exceeded expectations so far – growth could lift above 3% in 2017 as the dairy sector recovers. That's well above the decade average of 2.1% to 2015. Hints of a dairy sector recovery emerged in mid-August auctions, which saw the price of whole milk powder jump by 45%yoy to US$2,695 a tonne, closing in on the $3,000 break-even level for many farmers, who have suffered two bad seasons in a row. While the price jump in August likely reflects a brief window to December for imports into China with low tariffs, long-term capacity is reducing. The dairy herd is likely to drop by 5% this year after a 3% fall last year, and that translates into a 5% production fall in the current season.

Firm consumer demand

… thanks to migrants, jobs, & rising debt

Private consumption growth has been steady around 2.6%yoy since Q1'14, despite a big drop in the income of dairy farmers. Households have been helped by record low interest rates, record high home and stock prices (up 8.6% and 16% respectively since December 2015), and strong employment growth (up 4.5%yoy in Q2'16). Household credit growth rose to 8.4%yoy in Q2'16 from 5.6%yoy in Q2'15, adding to NZ's record high personal debt (163% of household income). However, low interest rates mean that the debt-servicing ratio is at multi-year lows. That should allow consumer spending to continue growing at about 2.5%pa in 2016 and 2017.

Capex growth eases as housing cools

Fixed investment growth is likely to settle at around 2.7%pa in 2016-17, after easing to 2.8% in 2015 from a 10.9% surge in 2014. Rapidly rising residential investment (13.6%pa) in 2012-14 gave way to slower 5% growth in 2015, as the pace of non-residential capex also eased to 2% from 9.7% in 2014. However, housing construction could briefly reaccelerate, following a rebound in residential construction permits in recent months.

Slashing rates to lower the NZ$

The RBNZ cut its policy interest rate to a new record low of 2% in August. It is likely to cut again in the coming months in an effort to lower the NZ$, which has surged 16% against the US$ from its September 2015 low. Meanwhile, inflation has slumped to 0.4%yoy in 1H'16 compared to the RBNZ's target range of 1-3%.

Calendar years	2013	2014	2015	2016	2017
GDP(Expenditure), real growth, %	1.7	3.0	3.0	2.5	2.8
GDP(Production), real growth, %	2.4	3.7	2.5	2.3	2.6
CPI, year average, %	1.1	1.2	0.3	0.5	1.0
Official cash rate, year end, %	2.50	3.50	2.50	2.00	1.75
NZ$1 = US$, year average	0.82	0.83	0.70	0.70	0.70
US$1 = NZ$, year average	1.22	1.20	1.43	1.43	1.44
NZ$1 = A$, year average	1.18	1.09	1.07	1.06	1.03

Source: 2013-2015 data from Statistics NZ; 2016-2017 forecasts by IMA Asia

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The Asia Pacific Executive Brief is produced by a unique network of in-country experts who run briefing and advisory programs that are designed to help senior executives monitor and anticipate critical business developments through timely insights and analysis. Further information on the markets and the peer group briefing programs is available from the Country Directors listed below.

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