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Global outlook

A synchronised global recovery

… continues delivering better than expected exports for Asia

… but watch out for EM risk as QE is cut in the US, EU and UK

Despite the confusion and noise of global politics, two important economic developments are underway. The first is a synchronised global recovery that has picked up all 35 OECD countries (the advanced economies) and 10 of the largest emerging markets (EM). That is producing the best demand we've seen in six years, and translates into a strong lift in Asia's exports, which has surprised us by maintaining its pace through the first two months of Q3'17. As a result, we are likely to continue with modest upgrades to our GDP forecasts for most Asia/Pacific markets over the next few months. The second development is a consistent signal from central banks in the US, the Euro area, and the UK that they intend to end quantitative easing (QE) soon, despite being quite a distance from inflation goals set at the start of QE. In doing that they have acknowledged that unexpected forces are keeping inflation low, which is a healthy reminder that none of us really knows how the exit from QE will work. One prominent consideration for EM is that the flood of liquidity that drove up asset prices (notably real estate) and supported EM currencies is about to end. See our comments on who might be hit by this in Asia at the foot of the Regional Outlook.

US growth is set to ease

… consumers pull back after a long expansion

… don't count on a tax cut boost

We expect the contribution of the US economy to global growth to be stable or ease next year, despite the current market excitement about a boost from US tax cuts. The consumer sector dominates, accounting for 69% of GDP in 2016. Two important indicators suggest that real growth in consumer demand is easing from the 2.9% average pace reported for the prior three years. First, consumer credit growth slowed to 4.1%yoy in July from 7.7%yoy last December, suggesting consumer caution and an interest in deleveraging. Second, light vehicle sales (cars and SUVs) have fallen throughout 2017, with August down 6.4%yoy. As a result, we expect real growth in consumer demand to ease to 2.2% this year from 2.6% in 2016, with around 2.0% likely in 2018. We think it's unlikely that Congress will deliver on tax cuts. Our 2017 and 2018 US forecasts are unchanged from last month.

A younger Euro zone recovery should continue lifting

Growth in the Euro area will match or better growth in the US over the next 18 months. In large part this is because the Euro zone expansion is only half as old as the US expansion, so the demand cycle is still in the recovery phase. As a result, fixed investment has been growing a lot faster than GDP (3.5%yoy versus 1.9%yoy) since 1Q'15, and new car registrations were up 7.8%yoy in August. That's been a big plus for manufacturers, with the Euro zone flash manufacturing PMI climbing to 58.2 in September from 57.4 in August. A stronger Euro against the US$ this year is a headwind for exporters, yet that appears to be offset by stronger demand at home. A European Commission survey of economic sentiment rose to 113.0 in September (the highest level since June 2007) from 111.9 in August.

China at last cuts excess capacity

China demand is central to the global recovery, and the current global upturn wouldn't have been possible without China's well calibrated stimulus over the last year. That's boosted demand and prices for commodities like coal, iron ore, and oil, and lifted demand for consumer and capital goods. Equally important, China has at last started reducing excess capacity across a range of industries. Rather than relying on market forces, Beijing is using stepped-up compliance inspections to close factories that fail to meet environmental standards. That's boosted profits for firms in China and will likely have helped profits for firms outside of China as well.

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	1.9	2.0
- Euro area	1.2	2.4	2.0	2.0	1.9
- Asia/Pacific (14)	4.4	4.4	4.8	4.8	4.6
- NICs (4)	3.5	2.2	2.4	2.8	2.6
- Developing or "EM" Asia (7)	6.8	6.7	6.8	6.4	6.2
- ASEAN (6)	4.4	4.5	4.6	5.0	4.9
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	1.50	2.00
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	115

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	1.7	1.4
China	7.3	6.9	6.9	6.7	6.4
Hong Kong	2.8	2.4	2.0	3.5	3.4
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	5.6
Malaysia	6.0	5.0	4.2	5.7	4.8
Philippines	6.1	6.1	6.9	6.5	6.2
Singapore	3.6	1.9	2.0	2.7	2.7
Thailand	0.9	2.9	3.2	3.3	3.3
Vietnam	6.0	6.7	6.2	6.1	6.3
India (CY)	7.0	7.5	7.9	6.1	6.3
Australia	2.8	2.4	2.5	2.2	2.6
New Zealand	2.8	3.2	3.5	2.8	2.8

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	1.6	1.8
Hong Kong (composite CPI)	4.5	3.0	2.4	1.7	2.2
Taiwan	1.2	-0.3	1.4	0.9	1.2
South Korea	1.3	0.7	1.0	2.3	2.9
Indonesia	6.4	6.4	3.5	3.8	3.8
Malaysia	3.2	2.1	2.1	3.9	3.6
Philippines	4.1	1.4	1.8	3.3	4.1
Singapore	1.0	-0.5	-0.5	0.7	1.2
Thailand	1.9	-0.9	0.2	0.7	1.4
Vietnam	4.1	0.6	2.7	3.8	4.1
India (CY CPI urban non-manual workers)	6.7	4.9	5.0	3.4	4.9
Australia	2.5	1.5	1.3	2.1	2.3
New Zealand	1.2	0.3	0.6	2.1	2.5

Exchange rate to US$1, year avg.	2014	2015	2016	2017	2018
Japan	106	121	109	112	115
China	6.16	6.28	6.64	6.74	6.81
Hong Kong	7.75	7.75	7.76	7.80	7.83
Taiwan	30.4	31.9	32.3	30.5	29.6
South Korea	1,053	1,131	1,160	1,136	1,115
Indonesia	11,868	13,389	13,308	13,262	13,388
Malaysia	3.27	3.90	4.14	4.30	4.09
Philippines	44.4	45.5	47.5	50.5	51.4
Singapore	1.27	1.37	1.38	1.38	1.33
Thailand	32.5	34.2	35.3	34.2	33.9
Vietnam	21,148	21,677	21,932	22,496	23,203
India (FY)	61.0	64.1	67.2	65.1	67.5
Australia	1.11	1.33	1.35	1.28	1.23
New Zealand	1.20	1.43	1.43	1.39	1.34

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

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Regional outlook

Political & policy issues to watch

Japan's snap election could hurt PM Abe

At the end of September, PM Abe called a snap election for October 22nd hoping for an easy win against a weak opposition Democratic Party. Within hours the game had changed, as popular Tokyo Governor Yuriko Koike launched her own national party, Kibo no To (Party of Hope), and then the Democratic Party announced that its candidates would run under the Kibo no To banner. If that combination works, which is far from certain, the October race could be close, and Abe's dominance in the ruling LDP and in Japanese politics would be diminished. We still expect an LDP win, albeit narrower than it might have been when Abe called the race.

Adjusting to Xi Jinping's rising power

October is also a big month for China, with the 19th Party Congress set to confirm a second 5-year term for Xi Jinping as party head, and for Xi's supporters to sweep appointments to the party's top posts. Xi, who is one of the most powerful leaders in China since 1949, will become even more powerful. Everyone in China, from distant provincial governors to foreign MNCs, will have to adjust to that. Asia will also have to adjust, as Xi pushes for a regional realignment at the same time as the US position in Asia fades. Both realignments emerged in the last few years, and they have much further to go.

N Korea risk keeps rising

… watch for China to curb Pyongyang

If you like political gossip, then one rumour is that both China and Japan have scrambled to pull key political events in late 2017 forward, as they suspect that North Korea tension will escalate at the end of the year. The cyclical pattern of North Korean risk has moved well outside the boundaries of the last five decades thanks to advances in Pyongyang's weapons and unpredictable leaders in both the US and North Korea. Kim Jong-un, North Korea's leader, is harder to predict and control, as he has broken the close ties with Beijing that both his father and grandfather cultivated. Yet, China remains the key player in North Korea's future, and its irritation with its wayward ally has seen Beijing take much tougher action to curb Pyongyang in the last month than before. Xi will be able to take even tougher action after his party's October congress.

Outlook for the market

Asia's steadily improving outlook

After five years of constantly trimming our forecasts for Asia Pac, a consistent pattern of upgrades has emerged this year and looks like continuing for several more months. That means growth is also looking better in 2018. There are two reasons for this. First, China pulled off a remarkably effective stimulus that lifted growth across its economy, while at the same time stepping up efforts to consolidate excess industrial capacity. That not only led to stronger growth, but also bought a welcome rebound in industrial profits. Second, Asia's 2017 export recovery has been stronger and run longer than we expected at the start of the year. As is often said in Asia, a rising river covers many snags.

… includes a bit less risk in China

China's 2016-17 stimulus was not only effective, but was achieved without a rise in national debt, which remained near the 260% of GDP level set last year. That has reduced China's risk of tumbling into a financial crisis, which has been one of the biggest threats to Asia's outlook for the last five years.

Hints of better growth in India and Indonesia

Growth in India and Indonesia has disappointed this year. This month's reading of the latest data suggests growth may be edging up in both countries as the year closes. India has struggled with last November's demonetisation and this July's GST implementation. August data on auto sales (a useful quick read on demand) suggests underlying demand is stabilising. Similarly, Indonesia's auto sales in July and August point to a recovery in demand, as does a jump in non-energy imports.

Asia's currencies to watch as QE winds down

Currencies across Asia have lifted this year for three reasons. First, it was another year in which quantitative easing (QE) in the US, EU, UK and Japan pushed capital into higher risk investments. Second, the US$ weakened from early 2017, as global portfolio flows realigned for better growth in the Euro zone and disappointment in the US. Finally, the 2017 export recovery meant rising trade surpluses in Asia, which pushed up demand for local currencies. The first of these three – QE - is about to go into reverse. While we may not see a repeat of the "taper tantrum" of several years ago (EM currencies plunged when the US Fed indicated that it would lift its policy rate), it will put pressure on Asia's weaker EM currencies. The two to watch are India's Rupee and Indonesia's Rupiah. Both gained from strong capital inflows in 1H'17, and both could lose, as global capital adjusts to a QE wind down. Any bad news from either country would exacerbate currency risk.

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Japan

Political & policy issues to watch

A snap election on October 22

… PM Abe should win a 3rd term

… but watch for a reduced majority

…as opposition pulls a surprise realignment

PM Abe has called a snap election for October 22nd hoping to benefit from the stronger economy, his recently improved approval ratings, and leadership disarray in the opposition Democratic Party. He did not anticipate that soon after calling the election, the Democratic Party will ask its candidates to run under the banner of Kibo no To (Party of Hope), a new party launched by popular Tokyo Governor Yuriko Koike. This will make the election a lot more challenging for the ruling LDP and Komeito, its coalition partner. The ruling coalition is still likely to win, but with a smaller majority than Abe expected when he called the race. A key issue to watch is whether it can keep its two-thirds majority, which Abe needs if he is to amend the constitution so that Japan's military can take offensive action offshore. That's his pet project, and it often takes precedent over other policies. Abe's approval rating has climbed back towards 50% from 26% in July, partly thanks to his firm stand against North Korea's missile tests. If the LDP does poorly, Abe's position as party head (and thereby PM) would be at question in the party's 2018 internal election. If the LDP does well, Abe could set his sights on steering Japan through the 2020 Tokyo Olympics to become the country's longest serving, post-war PM.

Little scope for fiscal stimulus

The election comes too soon for the government to ramp up spending to win support. However, MPs from the LDP will demand promises of extra spending to help retain their seats, although little extra spending will occur. Abe has also suggested that half of the funds raised from a planned sales tax hike in October 2019 to 10% from 8% will be diverted to education from debt repayment to help win support from families. That would lock in the tax increase, which many were hoping would be postponed for a third time.

Outlook for the market

A firm 2017 recovery

… as exports & local demand lift

We have lifted our 2017 GDP growth forecast to 1.7% from the 0.5% we forecast in June 2016. Two developments account for that. The global trade recovery has been stronger and longer than we expected, and Japan jumped on it one to two quarters ahead of the rest of Asia thanks to a cheap Yen and the right product mix for rising demand in China. The export rebound contributed to a strong lift in domestic demand via consumption and capex. As business and consumer sentiment indicators are running strong, we expect the upturn to run into 2018, with the pace ebbing to under 1% by 2019.

Exports lift

… as Japan makes the goods that China wants

Exports for the first two months of Q3'17 were up 7%yoy (US$ terms), slightly down from the 8%yoy rebound of 2H'16 and the 9%yoy lift of 1H'17. For the year to August, the strongest recoveries were to China (up 14%yoy, accounting for 16% of all exports) and ASEAN (up 10%yoy, 15% of total), with milder 5%yoy recoveries to the US (20% of total) and the EU (11% of total). The lift to China was across the board from chemicals through manufactured goods, machinery, transport equipment, and other goods. Full year export growth is likely to be 8%, followed by 3-5% in 2018 after 1%pa in the decade to 2016.

… providing a brief boost for manufacturing

Strong exports pushed the industrial production index up 3.8% for the year to July after an average fall of 0.9%pa in the decade to 2016. For full 2017, we expect 4.2% growth followed by 2-3% in 2018, and about 0.5% in 2019. That's led to a mild lift in capex on plant & equipment (up 2%yoy in 1H'17), and a small lift in factory employment.

A strong jobs market supports a jump in house-hold spending

Real growth in consumer demand jumped to 1.7%yoy in 1H'17 after averaging 0.5%pa over the prior decade. While wage growth is stuck at 1%pa, the jobs market has tightened with 1.5 openings for every applicant, a level not seen since 1991. Passenger car sales were up 8.5%ytd by August after falling 0.5%pa over the decade to 2016. Resident departures were also up 5.6%ytd by August after a fall of 0.1%pa over the decade to 2016. We expect real growth in consumer demand to ease to 1.4% next year from 1.6% in 2017.

Japan's lonely QE path means a weaker Yen

With inflation stuck below 1%yoy, the Bank of Japan will continue its quantitative easing (QE) program into 2019, while central banks in the US, Euro area, and UK end their QE programs and edge up policy interest rates. That will weaken the Yen for 12-18 months, before a mild trend appreciation returns sometime in 2019.

	2014	2015	2016	2017	2018
GDP, real growth (2005p), %	0.3	1.1	1.0	1.7	1.4
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	115

Sources: 2014-2016 data from the BOJ and government sources; 2017-2018 estimates by IMA Asia

China

Political & policy issues to watch

The October party congress

… Xi Jinping will get another 5-year term

… & his control over China will rise

The Communist Party will start its 19th congress on October 18. Party General Secretary Xi Jinping will get a second 5-year term as leader, and his control over China will increase. In his first term, Xi moved with surprising speed to dominate a decision making process that had previously balanced party factions. Since taking office in 2012, Xi has purged opponents in the party, state and military, particularly those aligned with his predecessors, Hu Jintao and Jiang Zemin. A key issue to watch will be the composition of the 7-man Politburo Standing Committee. Apart from Xi, Premier Li Keqiang is the only one not required to step down for exceeding the age limit, yet even his position is unsure. Wang Qishan, head of party discipline and Xi's right-hand man, should retire, but may be kept on to continue purging Xi's opponents. By recent tradition, a successor to Xi should also emerge, although there is speculation that Xi will overturn tradition, and start his second term by making clear that he aims for a third term.

Everyone needs to adapt to Xi's China

Xi has used his dominance to turn China onto a new course. From Deng Xiaoping's "open door" policies of the 1980s, through Premier Zhu's restructuring in the 1990s and WTO accession in 2001, to the 2013 "China 2030" Report by the NDRC and the World Bank, China had moved towards a more open, market-based economy. By contrast, Xi wants a party-guided economy, with a dominant position for state owned enterprises (SOEs). Foreign firms have a future, so long as they align with Xi's goals. That conditional operating license also applies to China's private firms, including its internet giants.

Watch out for more regulatory tightening

Four years ago, our clients reported that some local firms were being closed due to tighter implementation of environmental regulations. The last year has seen a dramatic escalation in new rules and their enforcement. Foreign firms have been quick to adapt, but many local firms have been closed, hopefully for good. That has improved pricing conditions.

S&P's downgrade won't slow US$ bond borrowing

China is skirting a financial crisis, and the risk of a financial meltdown is one of the biggest risks confronting China and Asia. S&P has just cut China's sovereign debt rating one notch to A+ from AA-, reflecting China's slow progress on halting debt-fuelled growth. The downgrade will have little impact on a surge in US$ bond issuance by mainland firms in HK, as their yields of 4.5-5.5% are keenly sought by investors.

Outlook for the market

A strong lift in current growth in 2017

… boosts profits while curbing defaults and unemployment

China has grown faster than expected in 2017, with our mid-2016 real growth forecast of 5.6% lifted to 6.7% several months ago. We had expected Beijing to clamp down on credit growth. Instead, growth in corporate and consumer debt accelerated, and China turned in 6.9%yoy GDP growth in 1H'17. Stimulatory policies in infrastructure and housing also kicked-in, producing a jump in demand for commodities, building materials, and machinery. As a result, producer price inflation swung from -5.9%yoy at end 2015 to +6.3%yoy this August. Nominal GDP growth (real + inflation) surged from 7.1%yoy for 1H'16 to 11.4%yoy for 1H'17. All of that produced a surge in profits for industrial companies, which limited bond defaults and growth in unemployment. There's plenty of impetus to keep this party rolling into 2018, although with less stimulus in infrastructure, housing, and auto sales the pace will cool to 6.4% in 2018. It would only fall under 6% if Beijing decides to slow credit growth after the Communist Party congress is out of the way.

Growth cools in 2018 as stimulus eases

The boost in nominal GDP growth, which aligns with sales value rather than sales volume, ended the 2-China phenomenon of heavy industry facing flat or contracting sales, while services and some modern industry grew sales at 8-12%. Nearly all sectors have sales growth of 8-12%yoy today. This should run to mid-2018, but after that, heavy industry is likely to face renewed downward pressure on prices and little sales growth.

A brief Yuan rally should end soon

Over the last 18 months, Beijing showed it could limit capital outflows and halt the Yuan's fall. An adjustment to the PBOC's daily exchange rate setting ever triggered a rise on a sliding US$ from 6.9 in May to 6.5 in September. Once the party congress is over, we expect a mild depreciation to return, along with an easing of restrictions on capital outflow.

	2014	2015	2016	2017	2018
GDP, real growth, %	7.3	6.9	6.9	6.7	6.4
CPI, year average, %	2.0	1.4	2.0	1.6	1.8
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	6.74	6.81

Sources: 2014-16 data from CEIC and government agencies; 2017-18 forecasts by IMA Asia

Hong Kong

Political & policy issues to watch

HK's difficult path on identity politics

Administrative capacity in HK continues to suffer from a divided Legislative Council (Legco), where a minority of pan-democrat and localists members obstruct government bills, as they object to Beijing's encroachment on HK's independent administration. Six Legco opponents of the administration have lost their seats in the last few months; by-elections have been called for four seats next March, with the other two likely to follow soon after. Those contests should show whether Chief Executive Carrie Lam is winning popular support with policies aimed at easing soaring housing costs, improving education and healthcare, while moderating anti-Beijing/mainlander sentiment.

A credit ratings cut that follows China

S&P has cut HK's sovereign bond rating from AAA to AA+ following a downgrade to China, as a national risk re-rating normally flows through to sub-national territories. That will have little impact. A bigger issue is how HK handles rising US interest rates (see below).

Rising risk from soaring home prices

Rising US interest rates and an end to quantitative easing (QE) by the US Fed will eventually push up the HK mortgage rate at roughly the same time that the administration encourages a surge in apartment building. That's a threat to HK's soaring home prices, which are among the most expensive in the world and were up 22%yoy in June. Finance Secretary Paul Chan has urged new home buyers to be cautious. A repeat of the property price plunge that began 20 years ago (a 66% slide from October 1997 to May 2003) would decimate consumer demand.

Outlook for the market

Local demand boosts growth in 2017

HK's 4%yoy GDP growth in 1H'17 was the best first half since 2011 thanks to strong growth in domestic demand – up 5.4%yoy - led by consumer spending and fixed investment (the GDP result was lowered by a rise in the net export deficit, as import volume growth exceeded export volume growth). Our 2017 and 2018 GDP growth forecasts have edged up slightly from last month, although we still expect a slower pace in 2H'17, as China's growth cools.

A broad services sector upturn

Real growth in services, which account for 90% of GDP, rose to 3.3%yoy in 1H'17 from 2.3% last year, as all of the trade-driven sub-sectors increased Real estate, financial services, and telecoms also did well. Supporting the trade sector recovery was an 11% lift in the annual rate for ladened containers at the port to 17.9m units by Q2'17, after no growth in 2016 and a 10% fall in 2015. The bigger story is that the June 2017 annual rate matched that of June 2005, highlighting the shift in trade to cheaper nearby ports in China.

… plus mainland Chinese tourists

After falling 3% in 2015 and 7% last year, mainland arrivals (mostly tourists) rose 2.3%yoy in 1H'17, and, as mainlanders account for 77% of all arrivals, that saw a 2.4%yoy rise in all arrivals after two years of declines. Even though hotel occupancy rates were at 90% in July, achieved average room rates have been falling for three years.

A recovery in consumer demand

The services recovery boosted employment growth to 1.1%ytd by August from 0.2% in full 2016, that helped lift real growth in consumer demand by 4.6%yoy in 1H'16, well above last year's 1.8% increase, and close to the decade average (to 2016) of 4.4%pa. We expect private consumption to grow 4%, followed by 3.5-4.0% increase in 2018.

Watch for higher HK interest rates

HK's policy interest rate must track that of the US Fed because of the HK$ peg to the US$. Despite four policy rate hikes in lockstep with the Fed since December 2015, local bank lending and savings rates haven't budged. That may be about to change, as the US Fed raises rates and ends QE, which had previously swamped HK with funds and allowed commercial banks to avoid rate hikes. The HK$ will likely hit the bottom of its 7.75-7.85 trading band on the US$, as liquidity drains, and local banks are forced to lift their rates.

	2014	2015	2016	2017	2018
GDP, real growth, %	2.8	2.4	2.0	3.5	3.4
Composite CPI (04/05), year average, %	4.5	3.0	2.4	1.7	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	7.80	7.83

Sources: 2014-2016 from Censtat, HKMA, and CEIC; 2017-2018 estimates by IMA Asia.

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Taiwan

Political & policy issues to watch

William Lai takes over as Premier

… boosting support for President Tsai

A key question for Taiwan is how much difference newly appointed Premier William Lai can make. His president, Tsai Ing-wen, has struggled to implement a populist agenda since she started her first four-year term in May 2016, even though her party, the DPP, also won a majority in the legislature (the first time a party other than the KMT has had a majority). From the start, her administration has struggled with a lack of experience and a clash between popular policies (like closing nuclear and coal power plants) and market realities (like running out of power). By August this year, her poll support had fallen to 29.8%, partly because she spent considerable political capital this year in pushing through reforms to public sector pensions, which prior governments had dodged. In one respect, Lai's appointment as Premier has been of immediate help to Tsai, as his popularity with voters has lifted Tsai's own poll support back to 46.4% following a cabinet reshuffle by Lai after his appointment. Poll support for the KMT, which ruled Taiwan for most of the last six decades, is at 18.9%, as it has struggled to develop a role as an opposition party.

Lai plans to stick with Tsai's populist agenda

… which won't help growth

Lai's promise is to make progress on President Tsai's populist policies is worrying if he can't, at the same time, amend them to match market realities. That includes adjusting the DPP's entrenched desire to tack away from China, which angers Beijing and puts at risk massive commercial ties that are vital to Taiwan's economy. It also includes pressing ahead with Tsai's power reforms, despite warnings that they raise country risk by reducing the certainty of power supply.

Outlook for the market

Continued mild growth at 2%

… as the surging global chip cycle fails to lift growth

Despite playing a central role in the global supply chain for high tech consumer goods, for which demand has boomed, Taiwan's economy is running flat, with GDP growth stuck close to 2%yoy for the four quarters to Q2'17. On the production side of the economy there are two challenges: industry has hollowed out, with offshoring of production mostly to China; and a surge in capex to support the current jump in chip production occurred in 2015 and 2016, so fixed investment has slumped this year. Meanwhile, private consumption has stuck close to a 2%pa pace, while growth in government consumption has averaged just 1.2%pa over the six quarters since Tsai took office. Despite Tsai's plans to jump start growth by big public spending on infrastructure and lifting wages, we don't expect much change to the established growth pattern. The government expects growth of 2.1% this year and 2.3% next year.

Watch for strong exports to cool in Q3'17

Exports climbed 12.5%yoy in 1H'17 after four years with an average annual fall of 2%pa. There's no sign of slowing in the first two months of Q3'17, with export growth sticking at a 12.6%yoy pace. That's a plus for the outlook, as exports have remained strong much longer than we were expecting and if that rolls into Q4'17 we'll have to lift our growth forecast. Yet industry appears to expect growth to cool, as import growth (much of which is materials and components), which had surged 16.5%yoy in 1H'17, slowed to 6.6%yoy growth in the first two months of Q3'17. The annual trade surplus is close to an all-time high of US$29bn set in October 2015 and that's putting upward pressure on the NT$. Growth in industrial production, however, eased to 4.4%yoy for the first two months of Q3'17 from 4.7%yoy for 1H'17, confirming the hint in import data that the three-quarter surge in export manufacturing to Q2'17 is softening. For the full 2017, we expect industrial production growth of 3.4% from 2% last year, with growth of 2.5% likely next year.

The NT$ will stay firm

After climbing against a weak US$ from 32.0 last December to 30.2 for August, the NT$ has slipped through September, mostly as a result of rising geopolitical risk in North Asia and a firm signal from the US Fed that it will start unwinding QE. However, Taiwan's persistently strong trade surplus should put mild upward pressure on the NT$ into 2018.

	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	0.9	1.2
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: 2014-2016 government data and CEIC; 2017-2018 forecasts by IMA Asia.

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South Korea

Political & policy issues to watch

President Moon pursues big changes to business in Korea

After 10 years of right-wing governments, Korea swung to the left in May 2017 with Moon Jae-in winning the presidency, although his Democratic Party holds just 40% of the assembly seats from the 2016 legislative race. That will temper his policy agenda, which includes curbing the powerful family-run chaebols (conglomerates), supporting workers and small and medium enterprises (SMEs, who employ 85% of the workforce), and boosting the state's role in the economy. Koreans have a love/hate relationship with their mighty chaebol: most parents hope their kids join one, yet they are increasingly angry over corrupt chaebol-politician ties. The stock market backs Moon, as his push to end complex chaebol ownership structures, which underpin family control, should lift returns for other investors.

Plans to boost local demand

… with big changes in public spending

Moon's push to lift the role of domestic demand means weaning the economy off its export manufacturing engine, where long-term growth has ebbed, and curbing the wild cycles in the property market, which is currently soaring. With that in mind, he has proposed a rise in minimum pay and a 7% lift in public spending in 2018 to fund extra public-sector hiring, along with welfare and defence. The fiscal plan also includes a 20% cut in infrastructure spending to keep the budget deficit at 2%, and hold public debt under 40% of GDP.

N Korea risk

… S Korean industry has been hit hard

Escalating tension with North Korea and China could swamp Moon's policy plans. Like prior left-wing administrations, Moon won office promising better ties with Pyongyang. He's had to ditch that following the recent missile antics of North Korean leader Kim Jong-un. As a result, South Korea's economy has taken a direct hit from China's retaliation over Seoul's swing back to closer military ties with the US. China is the biggest offshore market for Korean firms, yet their sales there are plunging, as Chinese customers and suppliers turn away from them and regulators harry them. In addition, a 46%ytd plunge in tourist arrivals from China by July pulled total tourist arrivals down 21%ytd.

Outlook for the market

Local demand surged in 1H'17

While exports have recovered, it is local demand that is driving growth in 2017. Domestic demand surged 4.8%yoy in 1H'17 from 3.6% in full 2016, while GDP growth was held to 2.8%yoy (in line with 2016), as import volumes grew a lot faster than export volumes. We expect the surge in domestic demand to ease of the next 18 months, while net exports start to play a more positive role, as the recent import surge eases.

Watch for capex growth to ease

A 15.9%yoy surge in machinery & equipment (M&E) investment helped lifted capex growth to 10%yoy in 1H'17 from 5.2% in full 2016. That surge, which reflects rising global demand for electronics, may be cooling, as the latest trade data shows capital goods imports falling 7.4%yoy in July-August after a 22%yoy increase in 1H'17. Construction growth also started easing (8.1%yoy in Q2'17 from 11.3%yoy in the previous four quarters), as the authorities took steps to cool an overheated property market. This should trim fixed investment growth to 3.8% in 2018 from 8.5% in 2017.

While consumer demand stays firms

Consumer sentiment has surged since President Moon took office, with passenger car sales up 10.7%yoy in July-August after a 5.2%yoy drop in 1H'17. Moon's pro-labour policies should lift real growth in consumer spending to 2.7% in 2018 from 2.3% in 2017 and 2.5% in 2016.

More upside for the Won

Inflation rose to a 5-year high of 2.6%yoy in August, but the manufacturing sector continues to operate with plenty of excess capacity. This will likely push the timing of monetary tightening by the BOK into late 2018. The Won is up 7% against the US$ since early 2017. Long-term inflation differentials with the US suggest that the Won is fairly valued, although it could rise further if the US$ remains on a broad downtrend.

	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	2.3	2.9
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	1,136	1,115

Sources: 2014-2016 government data (NSO, BOK) and CEIC; 2017-2018 forecasts by IMA Asia.

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Indonesia

Political & policy issues to watch

President Jokowi has pulled ahead of opponents

… and is well positioned for the 2019 election

Thanks to deft political manoeuvring, President Joko Widodo ("Jokowi") has come out on top of a series of bruising political battles since taking office for a 5-year term in October 2014. Opinion polls show him well positioned to win a second term in the 2019 election, as his trust level with the public is high, and no opponent comes close to his ranking in opinion polls. Despite his political success, he has not been able to deliver on his core election promise of helping all Indonesians by lifting growth to 7.5%. Instead, growth has stalled at 5% over the last two years. Jokowi's challenge in lifting growth is that virtually all politicians and bureaucrats distain the private sector and particularly foreign investors, which accounts for lots of red tape and that has hurt foreign firms and national growth.

A blizzard of red tape hinders foreign firms

Foreign firms in Indonesia are grappling with aggressive audits by the tax office, a new policy from July to halt goods imports by wholesalers, and an e-catalog system that creates havoc in sales to the public sector. Indonesia's small traders have launched a campaign to roll back the ban on their role in goods imports, and we'll see if the government responds. In the interim, it has undermined an important channel for foreign MNCs in Indonesia. More regulatory challenges lie ahead, as the government is putting together an implementation package for a new law that requires wide-ranging halal registration for all consumables and even for clothing.

Tight fiscal policy

… has cut macro risk

With an eye on the 2019 elections, next year is shaping up as a crucial period for the national political contest. Jokowi wants to lift spending on poorer households in 2018, but will have to work within a cap on spending growth of just 2.4% imposed by Finance Minister Sri Mulyani. Her conservative fiscal stand has capped public debt at a low 28% of GDP, helped Indonesia win back investment grade status from ratings agency S&P in May, and put the 10-year government bond yield near a record low of 6.39%. It also helped keep inflation in check, encouraged capital inflows into bonds, and supported the Rupiah.

Outlook for the market

Hints of better growth from Q3'17 after years of 5%

Q2'17 GDP growth came it at 5%yoy, with almost no change in the pace over the last 14 quarters. However, Q3'17 is witnessing better exports and a domestic demand recovery, which is apparent in both import data and vehicle sales. While this month's forecasts for 2017 and 2018 are unchanged from last month (and are close to those by the IMF and the government), we'll lift them next month if the uptrend continues.

Exports are strong

… & a jump in imports & sales of cars and bikes hints at a local demand lift

Thanks to better coal and palm oil prices, Indonesia's export growth rebounded from an average annual fall of 6.5% over the last five years to a 14%yoy increase in 1H'17 and 29%yoy in the first two months of Q3'17. That pushed the annual trade surplus in August to US$13.5bn, which has supported the Rupiah. The bigger story, however, is on the import side, with growth in non-oil and gas imports rebounding from four consecutive annual falls to 6%yoy increase in 1H'17, followed by a 31%yoy lift in the first two months of Q3'17. Vehicle sales also hint at a recent lift in local demand. They were flat in 1H'17 after 4.9% growth in 2016, but then climbed 15%yoy in the first two months of Q3'17. Motorcycle sales fell 8.5% last year and 8.9%yoy in 1H'17, but then spurted 31%yoy in the first two months of Q3'17. We expect real growth in consumer demand in 2017 to be close to last year's 5%, followed by a lift to 5.6% in 2018. That's encouraging and a step up from the 4%pa pace for the two decades to 2016.

Watch for the Rupiah to slip as QE ends in the US and EU

Weak demand has kept inflation stable in a 3-4%yoy range since late 2015 and we don't expect this to change in the next year. With the Rupiah stable against the US$, the central bank has made two rate cuts in Q3'17 and will likely halt there. However, watch for a return of Rupiah weakness as the US, the EU, and UK all move to end QE in the next year.

	2014	2015	2016	2017	2018
GDP, real growth, %	5.0	4.9	5.0	5.4	5.6
CPI, year average, (2012=100), %	6.4	6.4	3.5	3.8	3.8
Central bank rate (7-day RR) at Dec %	-	6.25	4.75	4.00	4.25
Rupiah to US$1, year average	11,868	13,389	13,308	13,262	13,388

Sources: 2014-2016 government data (BPS, BI) and CEIC; 2017-2018 forecasts by IMA Asia

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Malaysia

Political & policy issues to watch

Election likely to be postponed into early 2018

Encouraged by a modest gain in the opinion polls, better growth, and a fragmented opposition, PM Najib Razak had been planning an early election for late 2017 (it needs to take place by August 2018). However, it's likely he'll have to wait until early 2018, as a redrawing of electoral boundaries designed to favour the ruling UMNO party is being challenged in the High Court. Waiting a few more months won't hurt UMNO, as growth is expected to remain firm, and the FY2018 budget (to be presented on October 27) will allow Najib to announce more vote-winning spending on rural Malays, who form a critical support base. In July, the government announced an M$1.6bn (US$373m) assistance package to disgruntled palm-oil farmers (mostly Malays) who operate under the Federal Land Development Authority (FELDA). Its leadership, consisting of ex-UMNO politicians, has been forced to step down because of alleged corruption.

Opposition disunity helps unpopular Najib

PM Najib has managed to deflect damage from the 1MDB scandal, but needs to improve on the result of the 2013 election, when UMNO lost the popular vote even though it won a comfortable majority of seats. His chances of doing so have improved, as the opposition is split between the hard-line Islamic PAS party and Pakatan Harapan, a coalition of ex-UMNO politicians that includes ex-PM Mahathir and ex-DPM Anwar, together with the DAP, an ethnic Chinese-based party. Pakatan Harapan's failure to say who will be PM if it wins suggests a lack of unity that won't impress voters.

Outlook for the market

GDP growth firming on improved consumption and export demand

GDP growth accelerated to 5.8%yoy in Q2'17, the fastest pace in two years, thanks to strong growth in private consumption, a lift in net exports, and inventory building. Q3'17 could be even stronger, as manufacturing output surged 8%yoy in July from 6.2%yoy in Q2'17 and 5.6%yoy in Q1'17. July exports were also strong rising 23%yoy from 13%yoy in 1H'17 (in US$ terms). Companies are clearly feeling the improvement in demand, with the August purchasing managers index (PMI) rising to 50.4 from 48.3 in July. Given strong momentum at the start of 2H'17, we've lifted our 2017 full year growth forecast to 5.7% from last month's 5.2%, with 2018 growth now raised to 4.8% (4.3% last month).

Improved household budgets allow faster spending amid deleveraging

Consumer demand has improved thanks to faster jobs growth (2.2%yoy in June from 0.6%yoy in December 2016) and a 15% rise in cash transfers to low income groups (7m recipients) under the 1 Malaysia People's Aid program. That saw real growth in consumer demand lift to 7.1%yoy in Q2'17 from 6.0% in 2016. Q3'17 will likely be just as strong, as passenger sales increased 6.7%yoy for the first two months of Q3'17 after a 4.7% rise in 1H'17 and a 13% drop in 2016, after flat years in 2014 and 2015. For 2016, we expect 6.9% real growth in consumer demand, easing to 6.3% in 2018 from 6.0% in 2016.

Falling capital goods imports point to slower capex growth ahead

We expect infrastructure (mostly road and rail transport), along with public housing construction to sustain fixed investment growth of 5.5% in 2017 and 4.5% in 2018, faster than the 2.7% of 2016. However, private real estate activity is likely to ease, with the housing, retail and office segments all facing oversupply. A recent steep decline in capital goods imports (-22%yoy in July, US$ basis) suggests that capex activity is set to decelerate in the coming quarters.

More upside potential for the M$ after 7.3%ytd gain

Inflation eased to 3.2%yoy in July from a 5.1%yoy in March, partly thanks to a 7.3% rise of the M$ against the US$ since the start of this year, which made imports cheaper. An easing in inflation should allow Bank Negara to delay lifting its policy interest rate until late 2018. Based on long-term inflation differentials, the M$ still looks undervalued on the US$, so we expect a mild appreciation to continue into 2018 against a weaker US$.

	2014	2015	2016	2017	2018
GDP, real growth, %	6.0	5.0	4.2	5.7	4.8
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	4.30	4.09

Sources: 2014-2016 data from government, Bank Negara, & CEIC; 2017-2018 forecasts by IMA Asia.

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Philippines

Political & policy issues to watch

President Duterte is still popular

…but cracks are starting to appear

Fifteen months into his single six-year term, President Duterte's popularity remains high (82% approval rating in July). However, Duterte's highly autocratic style and the violence of his anti-drugs campaign (more than 3,800 extra-judicial killings) are boosting the ranks of his critics and could start affecting his poll ratings. There are hints of unease in recent threats to impose nationwide martial law if human rights demonstrations turn unruly, and fierce attacks by the president and his allies in Congress against prominent critics, such as the country's Vice President, the Supreme Court chief justice, and the government's ombudsman investigating corruption. All three have been threatened with impeachment.

Massive infrastructure spending could risk fiscal stability

Despite his oversized majority in both houses of parliament, Duterte is finding it hard to pass undiluted his revenue raising bills (they include a lift in the petroleum excise tax and wider VAT coverage), which are needed to finance his massive infrastructure program. Duterte aims to lift public spending on infrastructure to 7.4% of GDP by the end of his term from 5.4% this year. US$26.6bn worth of projects has been approved since he took office, out of the US$180bn he plans to spend on infrastructure by 2022. The latest approvals were projects worth US$7.6bn in mid-September. They include bridges, roads and a US$7bn subway for Metro Manila, funded by Japanese aid. Amid this public spending spree, the government aims to cap the budget deficit at 3% of GDP, a task made more difficult by Duterte's unexpected order for free education in state colleges and universities.

Outlook for the market

A welcome growth slowdown to cool overheated economy

GDP growth eased to 6.4%yoy in 1H'17 from 6.9% in full 2016, as domestic spending growth fell to 7.2%yoy from 11.3%. The softer slide in GDP growth relative to that of domestic demand reflects a pickup in export volume growth to 20%yoy from 10.7% in full 2016. Private consumption and fixed investment both lost momentum, helping to arrest the rapid deterioration of the Philippines trade balance via weaker appetite for imports. The 12-month rolling trade deficit narrowed to US$26bn in July from US$27.4bn in March, the largest since data became available in the early 1980s. This is a welcome development, as persistent economic overheating can undermine growth via rising inflation, expanding external deficits, a sliding currency, and rising interest rates. We expect domestic demand growth to settle at around 7.3%pa, allowing GDP to grow 6.5% in 2017 and 6.2% in 2018.

Infrastructure extravaganza to drive capex growth

Fixed investment growth eased to 9.4%yoy after consistently expanding at a hectic 18.8%yoy over Q3'14-Q1'17. Both construction and plant & equipment capex contributed to the slowdown, but this is unlikely to persist. The government's massive infrastructure program should help sustain capex growth of 11.2% in 2017 and 10% in 2017 from an unsustainably fast 25.2% in 2016. It would be strong enough to offset a mild cooling of residential construction (reflected in slowing building permits) and weaker foreign direct investment (FDI) inflows from a US$7.9bn record high in 2016.

Household finances are solid

… but watch BPO weakness

Improved employment prospects (unemployment hovering at a multi-decade low of 5.6%) and steady growth of remittances sent by Filipinos working overseas (5%ytd by July, unchanged from the pace set in full 2016), should keep private consumption growth slightly above 6%pa in 2017-18. A risk to watch is recent weakness in BPO export income, which may affect household spending capacity if it persists. Technological innovation could disrupt the country's thriving BPO sector.

Rising CPI and interest rates with a soft Peso

We expect the central bank to start lifting it policy interest rate by the end of this year, in line with rising inflation. The CPI was up 3.1%ytd by August from 1.8% in 2016 and is heading to 4% in 2018. Tighter monetary policy may help slow the descent of the Peso, which has been a sustained downtrend against the US$ since 2013.

	2014	2015	2016	2017	2018
GDP growth, %	6.1	6.1	6.9	6.5	6.2
CPI, annual average, %	4.1	1.4	1.8	3.3	4.1
Central bank reverse rep. rate, year end	4.00	4.00	3.00	3.25	4.25
Peso to US$1, annual average	44.4	45.5	47.5	50.5	51.4

Sources: 2014-2016 data from BSP and CEIC; 2017-2018 forecasts by IMA Asia.

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Singapore

Political & policy issues to watch

The main political goal in 2018

… is better ties with China

With a wide-open economy driven by regional trade in goods and services, Singapore is quick to feel a shift in geopolitical winds. This is where its single party government, with the PAP ruling since independence 52 years ago, pays off, as it has allowed a delicate but consistent balancing act between its big Muslim neighbours, Indonesia and Malaysia, and between China and the US. That balancing act needs constant work, particularly this year, as US authority in Asia fades, while China's desire to lead the region becomes ever more apparent. PM Lee Hsien Loong's recent visit to China, just ahead of the Chinese Communist Party's congress in October, is an effort to mend ties, as China has signalled rising unease over Singapore's failure to wholeheartedly join the pro-China camp over the last year. By long tradition, Singapore still sends its troops to train in Taiwan and Australia, supports the US military presence in the region, and wants the South China Sea to remain open to free navigation. More recently, it has been wary of China's "One Belt One Road" project, which is likely to limit future growth of its own port and airport. For its part, China, which is Singapore's top export destination, is suspicious of Singapore's close ties with the US and Taiwan. Like much of the rest of southeast Asia, we expect Singapore to gradually realign with China over the next few years.

A solid credit rating as banks handle weak energy & real estate sectors

Fitch affirmed its "AAA" credit rating for Singapore's sovereign debt with a stable outlook thanks to the country's exceptionally strong external balances, a sound fiscal framework backed by high net public savings, and high per capita income. Given its high dependence on global trade and investment flows, which can be volatile, Singapore must maintain a strong credit rating to curb risk. Fitch was pleasantly surprised by the resilience of Singapore's banks, as it has had them on a negative watch list because of their high exposure to the struggling oil & gas sector, and the declining real estate market.

Outlook for the market

Local demand is falling

… but better exports lift GDP

GDP growth edged up to 2.7%yoy in 1H'17 from 2% in full 2016 without help from the domestic economy, which contracted 1.4%yoy in 1H'17 on the back of declines in private consumption and capex. Most of the growth came from a big lift in inventories, with some slight support from net exports. We expect domestic demand to stage a gradual recovery from 2H'17, which will lift its growth to 2.4% in 2018 from -0.2% in 2017. Along with improved net exports, this should result in GDP growth of 2.7%pa in 2017-18.

Consumers pull back due to falling home prices

… and a weak jobs market

Private consumption fell 0.3%yoy in 1H'17 after a weak 0.6% increase in 2016. Households have been adjusting to a mild but protracted fall in home prices (down 11.6% from a Q3'13 peak) and weak labour demand. Even though the resident unemployment rate is low at 3.2%, employment fell 0.2%yoy in 1H'17, while the ratio of job vacancies-to-job seekers slid to 0.8 from 1.4 in 2014-15. Wage growth also eased to 2.9%yoy in the year to Q2'17 from 3.9%yoy in the year to Q2'16. However, household balance sheets remain strong, and an expected turnaround in the residential property market (hinted at by a strong lift in housing transactions) should boost consumer confidence. We expect real growth in consumer demand to edge up to 1.3% in 2018 from flat in 2017.

A 2017 fall in capex should reverse in 2018

Fixed investment fell 5.6%yoy in 1H'17 after a 2.5% drop in full 2016, on the back of large declines in residential construction (-14.5%yoy) and plant & equipment (-7.2%yoy). The value of construction contracts awarded remains on a steep downtrend, but the decline in home prices is easing, while housing transactions shot up 56.7%yoy in 1H'17. Moreover, a recent turnaround in net investment commitments in manufacturing and services suggests that the worst could be over for plant & equipment capex. We expect fixed investment growth to edge up to 2-3% in 2018 after a 2.8% fall in 2017.

Little inflation and a rising S$

A rising S$ has kept inflation subdued (0.4%yoy in August from 0.7%yoy in 1H'17). The S$ is up 7.2% on the US$ since January this year, and should continuing gaining ground while the US$ stays weak. The value of the S$ is managed on a daily basis by the MAS as its main method of controlling inflation.

	2014	2015	2016	2017	2018
GDP, real growth, %	3.6	1.9	2.0	2.7	2.7
CPI, year average, %	1.0	-0.5	-0.5	0.7	1.2
3-month interbank interest rate, Dec, %	0.46	1.19	0.97	1.10	1.30
S$ to US$1, year average	1.27	1.37	1.38	1.38	1.33

Sources: 2014-2016 data from government, MAS and CEIC; forecasts for 2017-2018 by IMA Asia

Thailand

Political & policy issues to watch

A late October funeral will halt Bangkok

The five-day funeral of the late King Bhumibol Adulyadej, who died a year ago, will start on October 25, bringing Bangkok to a standstill, with many Thais entering the capital to pay their respects. All marketing plans should be carefully vetted and muted through October to show respect. October 26 has been declared a public holiday.

Plans to entrench military-guided government in 2018

After the funeral, Thailand has a packed year, as the military government led by PM Prayut who was installed by a coup in 2014, attempts to transform into a military-guided government with a veneer of elected legitimacy. A new constitution, drafted under military guidance, has been adopted, and elections will be held in late 2018 for a new lower house. It's unlikely that politicians associated with ex-PM Thaksin will be allowed to contest the poll, and the recent flight of Thaksin's sister, ex-PM Yingluck, removes the best candidate to lead the pro-Thaksin camp. A military appointed senate will have control over the elected lower house and will play a role in choosing the next PM, who might be Prayut.

A new alignment in the military

… shifts the centre of power

The coronation of the new King, Maha Vajiralongkorn, will follow his father's funeral. The annual appointments of senior military officers in early September also saw a realignment, favouring members of the Kings Guard (the First Infantry Division under the First Army Region, which is responsible for Bangkok security) over the Eastern Tigers (the Second Infantry Division, which includes the Queen's Guard), which has dominated since 2004. The realignment positions Gen. Chalermchai Sitthisad, who was reappointed as military head, as a possible successor to General Prayut, who was military head during 2010-2014.

Moving forward on the EEC

A bill to launch the Eastern Economic Corridor (EEC) project, which aims to rejuvenate Thailand's industrial base and position it as the hub for the fast-growing Mekong region, was submitted to the legislature at the end of September. Infrastructure work on this special economic zone should start next year, with some US$45bn to be spent by 2021.

Outlook for the market

Steady growth around 3.3%

… as an export lift is offset by weak capex

GDP growth edged up to 3.5%yoy in 1H'17 thanks to stronger exports, while consumer spending held steady at the 2016 rate of 3.1%yoy. The weak part of the economy is private capex growth, which grew just 1%yoy in 1H'17 after a 1%pa average fall over the prior four years. Political risk has been part of the problem, but other factors deterring growth in new investment have been flat consumer demand and little growth in exports, particularly from the big automotive and electronics sectors. Even though the labour market is tight, companies have plenty of capacity – in some sectors too much capacity – for existing demand. There is upside potential to our 3.3% growth forecast for 2017 and 2018 if exports continue to do well and a long overdue lift in capex emerges.

Trade data hints that industry is gearing up

Trade data to August hints at a local demand recovery that may emerge in 2H'17. While exports are up 8.9%ytd (US$ basis), import growth (ex-fuels) rose 13%ytd, mostly due to a 21%ytd jump in imports of raw materials and intermediate goods. That still left a healthy trade surplus of US$14bn for the year to August, well above an annual average $3bn over the prior six years. Consumer goods imports grew just 3.4%ytd, so we see little reason to lift our consumer demand real growth forecast from 3% this year and next year.

Interest rates saty low as the Baht edges up on a weak US$

The Baht has risen this year on a weakening US$, as an export recovery triggered a surge in the trade and current account surpluses. Inflation was just 0.3%yoy in August, suggesting little prospect of a lift in the central bank's policy interest rate from its current historic low of 1.5% in the next year. At best, a mild tightening may start in late 2018 if construction work related to the EEC picks next year.

	2014	2015	2016	2017	2018
GDP, real growth, %	0.9	2.9	3.2	3.3	3.3
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	1.75
Baht to US$1, year average	32.5	34.2	35.3	34.2	33.9

Source: 2014-2016 data from BOT and CEIC; 2017-2018 forecasts by IMA Asia.

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Vietnam

Political & policy issues to watch

The party cracks down on opponents

… with little impact on policy

Although Vietnam is edging towards a more open market economy, the country's communist party leaders have stepped up a crackdown on opponents within the party and dissidents outside the party this year. Corruption charges have recently been laid against allies of Nguyen Tan Dung, who lost his bid to become party general secretary in January 2016. That appears to extend to purges in PetroVietnam (a state-owned oil & gas firm) and in some state-owned banks. Party leaders in Danang, which will shortly host the 2017 APEC Summit, have also been accused of misconduct. So far, there's no sign of the purge affecting political or policy stability.

Foreign investors continue to pour in

Meanwhile, foreign investors remain keen on Vietnam's booming economy. Realised foreign direct investment (FDI) was up 5.1%ytd to US$10.3bn by August, while FDI pledges soared 37.4%ytd to US$13.5bn. UN data shows that FDI inflows have grown by an average 11.2%pa over 2012-16. Vietnam is also receiving large portfolio inflows, which have helped push the local stock market up 34% so far this year.

Seeking better ties with China

… as the US role in Asia fades

The election of US President Trump has undermined Vietnam's strategy for dealing with China over disputed territories in the South China Sea. Trump's disengagement from Asia, and US withdrawal from the Trans Pacific Partnership trade deal, have weakened Vietnam's position relative to China. This was evident in a June, when Vietnam hurriedly cancelled an offshore drilling contract with the Spanish firm Repsol after China threatened a military response. Vietnam is becoming more dependent on China every year, with China accounting for 9.5% of the pledged FDI into Vietnam so far this year, up from 4.3% in 2015. Chinese tourists also accounted for some 30% of total tourist arrivals in Vietnam so far this year, up from 12.5% in 2009.

Outlook for the market

On track for a strong finish to 2017

GDP growth eased to 5.9%yoy in 1H'17 from 6.2% in full 2016 after an oddly subdued Q1'17, when growth slipped to 5.1%yoy with the construction, manufacturing, and services sectors all slowing. Fortunately, all three sectors bounced back in Q2'17, and the early data for 2H'17 points to full year growth of 6.1% in 2017. While that's short of the government's 6.7% target, we think a 6%+ pace can be maintained through 2018. Q3'17 has started well, with July-August seeing an 11.8% rise in manufacturing output while exports jumped 21%yoy (US$ basis). Vietnam's manufacturing PMI has been in expansion territory (above the 50 threshold) for 21 months to August, with its latest reading showing rising new orders and higher input purchases. The tourist sector is also booming, with arrivals surging 31.3%ytd by August, up from 26% in full 2016.

A struggle to fund big projects

Having recovered from a 7.8% property-induced slump in 2011, fixed investment grew 9.9% in 2016 from 9.4% in 2015 on the back of strong FDI inflows, a recovery in housing construction, and a lift in infrastructure work. Capex growth is likely to ease to 8.5%pa in 2017-18, as the government is facing budgetary constraints in funding projects, such as the HCM metro railway. It is exploring privately funded options such as PPP and BOT financing schemes, but these may take time to materialise.

Consumer confidence hits record high

The 15.2%yoy drop in passenger car sales in July-August, after a 10.9%yoy increase in 1H'17 reflects anticipation of ASEAN car import tariffs dropping to zero in 2018, rather than emerging weakness in household spending. Consumer survey firm Nielsen reports that Vietnamese households are among the world's most optimistic, with the local Nielsen consumer confidence index hitting a record high in Q2'17. We expect private consumer growth to stay above 7%pa in 2017-18, in line with the 7.3% increase of 2016.

Rising inflation & a falling Dong

With the economy operating close to capacity, inflation is on its way to 4% in 2018 from 0.6% in 2015 and 2.7% in 2016. The government is resisting interest rate hikes that will hurt its growth targets, so faster Dong depreciation lies ahead. We expect it to ease 2.5-3.0%pa against the US$ in 2017-18, following declines of 1.2% in 2016 and 2.4% in 2015.

	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	3.8	4.1
Central bank refinancing rate, year-end, %	6.50	6.50	6.50	6.25	6.25
Dong to US$1, year average	21,148	21,677	21,932	22,496	23,203

Source: 2014-2016 data from the IMF and CEIC; 2017-2018 forecasts by IMA Asia

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India

Political & policy issues to watch

Has the Modi bandwagon stalled?

… watch the SME vote in key state elections

With GDP growth slowing for six quarters to a low of 5.7%yoy in Q2'17, concern is growing that PM Modi's drive to reform India and lift its growth – as he did for Gujarat as its Chief Minister over 2001-14 - has stalled. There are three problems. First, last November's demonetisation hurt growth but remains inexplicable, which undermines reform credibility. Second, problems with GST implementation may have been consistently under-estimated, and they may undermine growth (see below). Finally, little is being done to fix fundamental problems that have led to a collapse in domestic investment (such as bad bank debts, arcane labour laws, and problems with acquiring land). At present, popular support for PM Modi remains strong, but the pain of GST implementation could cost him his crucial support base in the massive small business and trading community. Six state elections over the next year, including Gujarat and Karnataka, will show whether the Modi bandwagon has stalled.

GST risks that need managing

… for firms

… and the government

Implementation of a goods and services tax (GST) is essential to creating a national market and to providing government with stable income to fund public investment. The main risk with GST implementation is that its complexity will have a negative impact on corporate cash flow in two areas: by slowing invoicing and payments, and by delayed refunds from the tax office to companies (like exporters). Part of the latter problem appears to be that the government is itself low on funds. It front-loaded this year's budget, with over 90% of FY2017-18 spending in the first four months (to July). It could turn to markets for funding, yet ratings agencies have indicated concerns that may lead them to downgrade India. As it already sits on the lowest investment grade rating, a downgrade would cost India a lot and would undermine business confidence. The game isn't over yet, as vehicle sales to August (see below) suggests a positive outlook. But a difficult first year for the GST has started, and gridlock on cash flow is a key risk.

Outlook for the market

Assessing the early GST impact

… vehicle sales to August point to stabilisation of demand

As always, India's vehicle sales provide a snapshot of recent demand. After a weak 2015, mostly due to drought across rural India, two-wheeler sales, a good measure of demand from the massive low-income market, accelerated through 2016 reaching 15%yoy growth in Q3 (Sept quarter). After demonetisation in November, sales fell for two quarters before a recovery in Q2'17. Passenger vehicle sales, reflecting middle class India, came through demonetisation with little disruption. Commercial vehicle sales also survived demonetisation, but then plunged 12.5%yoy in Q2'17. That plunge – reported by clients in many other sectors – reflected a strategy for many local firms of running down stocks and holding back on big purchases in the pre-GST quarter, as such purchases lacked a deductable GST. Fortunately, August vehicle sales data suggests a return to normalcy. Passenger vehicle sales rose by 9.3%yoy for the first two months of Q3 from 6.1% growth in Q2'17, commercial vehicle sales swung to 10.4%yoy growth after the Q2 fall of 12.5%yoy, and two-wheeler sales rose 14%yoy after 8.6%yoy growth in Q2.

A slump in capex will pull down GDP growth

Provided the government gets tax refunds running and fixes glitches with its GST portal, India should scramble into 2018 without a GST-driven crisis. A bigger issue is the slump in bank (non-food) credit growth into a 5-6%yoy range through 2017. That reflects - and undoubtedly contributes to - a slump in fixed investment growth to 1% over the year to Q2'17. The central bank has announced a scheme to help banks resolve their bad debts, but nothing has been done so far. As India's growth will continue to slow with so little investment growth, we've again trimmed our calendar year forecasts to 6.1% for 2017 (prior 6.3%) and 6.3% for 2018 (prior 6.9%).

Rates cuts & a weaker Rupee

The central bank may bow to pressure for rate cuts in the next few months. Along with rising risk concerns, that will see the Rupee fall by 3-4%pa against the US$.

Calendar year starting January	2014	2015	2016	2017	2018
GDP (MP, 2011-12), real growth, %	7.0	7.5	7.9	6.1	6.3
Inflation - CPI, %	6.7	4.9	5.0	3.4	4.9
RBI repo rate, December, %	8.00	6.75	6.25	5.75	6.25
Rupee to US$1, year average	61.0	64.1	67.2	65.1	67.5

Sources: 2014-2016 data from the government (NCI, RBI) and CEIC. 2017-2018 forecasts by IMA Asia with guidance from IMA India.

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Australia

Political & policy issues to watch

Bad politics lead to poor policy

… with little progress on big issues

Soaring electricity prices in a country that is a major energy exporter highlight a rise in political dysfunction in Australia over the last decade. It emerged after 25 years of political stability, solid growth, and good policy under both Labor and Liberal-led governments from 1980. Part of the problem is structural, particularly a short 3-year federal election cycle (with average terms being a little over two years), and poor alignment between state and federal governments in key areas like energy policy. But part is also the souring of political debate, with both main parties opting for savage personal attacks rather than policy debate, and a hard right-wing emerging in the Liberal Party that champions conservative causes and disregards climate science and markets in backing coal and undermining alternative energy. Thanks to a foundation of good policy in the 1980s and 1990s, Australia can cruise forward for many more years, but few voters or companies are happy with the poor state of politics and gridlock on big issues like energy, superannuation, education, and healthcare.

Watch for a change in PM and a change in government

The Liberal-led Coalition government of PM Malcolm Turnbull has been trailing the opposition Labor Party in opinion polls since late last year, and will likely lose the next election, which could take place in the second half of 2018. Turnbull's position as leader has been weakened by persistent attacks from a hard-right wing within his own Liberal Party that is led by ex-PM Tony Abbott. Abbott could well topple Turnbull in a party room vote before we get to the next election, bringing another swing in policy without a change in government. The battle within the Liberal Party has left Labor free to campaign on reducing social inequality by raising taxes for businesses, high income earners, and real estate investors, all of which is quite popular with voters.

Outlook for the market

At last local demand lifts after four weak years

A slowdown in GDP growth to 1.8%yoy in 1H'17 from 2.5% in 2016 masks a recovery in domestic demand after four years to 2016 in which domestic demand grew just 1.2%pa while GDP grew faster at 2.5%pa thanks to a surge in export volumes, as big mines and new LNG capacity came on stream. The lift in domestic activity by 2.2%yoy in 1H'17 reflects a swing back to growth for fixed investment after a 3-year decline. With export growth likely to slow, as China's economy cools over the next year, the recovery in domestic demand should help underpin GDP growth of 2.2% in 2017 and 2.6% in 2018.

A better outlook for consumers

… as the jobs market lifts

Private consumption has grown steadily at 2.6%pa since 2011, despite low employment growth (1.2%pa in 2011-16 compared to 2.3%pa in 2001-10), and weak wage growth (just 1.9%yoy in 1H'17 from 4.1%pa over 2005-08). Households have cut savings and run up debt to support their spending, helped by near record low interest rates. Employment growth has been accelerating in recent months, driven by a revival of full-time jobs. Total employment growth surged to 2.7%yoy in August from 0.8%yoy in December 2016, while full-time job growth rose to 3.1%yoy from -0.3%yoy. The improved jobs market has yet to lift wage growth, but should help cushion the impact of a cooling housing market on household budgets, and allow consumption to continue growing at 2.5%pa in 2017-18.

Capex returns to growth

… but housing cools

The 2.2%pa fall in fixed investment over 2013-16 ended in 1H'17 with a 1.2%yoy rise thanks to a lift in public infrastructure spending (up 14.6%yoy in 1H'17 from 10.7% in full 2016), and an end to the fall in mining investment. The emergence of these positive trends coincides with a downturn in private residential investment (-2.1%yoy in 1H'17 from 7.6% and 10.1% growth in 2016 and 2015), which we expect to continue. The net outcome of these trends should see fixed investment growing at a modest 1.6%pa in 2017-18.

Low inflation and a firm A$

While the RBA is encouraged by better jobs data, it's unlikely to lift its policy interest rate any time soon, despite inflation edging up to 2%yoy in 1H'17 from 1.3% in full 2016. The housing market is cooling, household debt is uncomfortably high (a record 123% of GDP), and the A$ has climbed 17% on the US$ from its January 2016 multi-year low – all of which suggests a rate hike will be delayed. Despite a narrowing of interest rate differentials with the US, the A$ is expected to maintain its ground on a weakening US$.

Year ending December 31	2014	2015	2016	2017	2018
GDP, real growth, %	2.8	2.4	2.5	2.2	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	1.28	1.23
US$1 = A$, year average	0.90	0.75	0.74	0.78	0.81

Source: 2014-2016 data from the ABS, RBA and CEIC; 2017-2018 forecasts by IMA Asia

New Zealand

Political & policy issues to watch

Waiting to see who forms government

… it's up to Winston Peters

It could take weeks before a new government emerges in New Zealand. The incumbent National Party led by PM Bill English did better than expected in the September 23 poll, but failed to secure a majority. It won 46% of the vote and 58 seats compared to 36% of the vote and 45 seats for the opposition Labour Party under its popular new leader Jacinta Ardern. They are both negotiating with the anti-immigration, anti-foreign investment NZ First Party (7.5% of the vote with 9 seats and led by maverick politician Winston Peters) to form a coalition government. Peters, who in the past has joined coalition governments led by both the Nationals and Labour, will drive a hard bargain for his support. The Nationals only need NZ First to form government, while Labour needs both the Greens (5.9% of the vote with 7 seats) and NZ First. Even though the Nationals are ahead in the popular vote and on seats, they could lose office if they fail to strike a bargain with NZ First.

Watch for a swing to nationalist policies

The Nationals, who have been in government since 2008, and were led by John Key until recently, skilfully dealt with the impact of the 2008-09 GFC and the devastation of the 2011 Christchurch earthquake, turning NZ to one of the OECD's fastest growing countries. Market-oriented economic reforms, strong growth in inward migration, and a property boom underpinned NZ's economic success, but also led to rising inequality, poverty, unaffordable housing, and homelessness. If English manages to form a new coalition government, then he'll need to address these issues. However, a deal with NZ First may also require slashing migrant inflows and a more interventionist approach in policymaking, including curbing the independence of NZ's central bank (RBNZ).

Outlook for the market

Surging local demand is cooling

… as migrant inflows and housing slow

While GDP growth eased to 2.4% in 2H'17 from 3.5% in full 2016, growth in domestic demand remained steady at 4.3%. The slip in GDP growth was caused by weaker net exports as strong local demand sucked in imports, while export growth was modest. Looking forward, it should be noted that rapid inward migration and strong residential construction – the two biggest drivers of local demand - have started losing momentum. Net migrant inflows eased to 4.6% for the year to August 2017 from 14% for the year to August 2016, and 37.8% for the year to August 2015. Meanwhile, growth in building consents is slowing, while housing transactions are falling. That should see domestic demand growth ease to 3.8% in 2017 and 2.7% in 2018 from 4.2% in 2016. As stronger net exports won't fully offset that, we've trimmed our GDP growth forecast to 2.8% for both 2017 and 2018 from 3.0% previously.

Capex growth will also ease

Fixed investment growth eased to 2.2%yoy in Q2'17 from 5.4%yoy in Q1'17 and 5.5% in full 2016, with both residential and non-residential building activity turning down (-1.4%yoy and -5.4%yoy respectively). The cooling property market will continue to weight on the construction sector, while the 11.5%yoy surge in plant & equipment capex in 1H'17 is also likely to subside. We expect fixed investment growth to ease to 1% in 2018 from 3% in 2017 from 5.5% in 2016.

… but consumer demand should be steady

Private consumption has been growing faster than GDP since 2010 (3.1%pa versus 2.6%pa) and this is likely to continue, as long as the unfolding real estate correction stays orderly. A high migrant intake limited wage growth to 2.2%yoy in 1H17 from 1.8% in full 2016, but strong jobs growth (4.4% in 1H'17 and 4.6% in full 2016) has been supporting consumer demand. We expect consumption to grow 4.3% in 2017 and 3.6% in 2018.

Low inflation and a firm NZ$

No early tightening of monetary policy is likely, as inflation remains tame (1.7%yoy in Q2'17 from 2.2%yoy in Q1'17) and the property market is cooling. Political uncertainty surrounding the September 23 elections unsettled the ascent of the NZ$, but we expect it to remain on the mild uptrend it has established against the US$ since late 2015.

Calendar years	2014	2015	2016	2017	2018
GDP(Expenditure), real growth, %	2.8	3.2	3.5	2.8	2.8
GDP(Production), real growth, %	3.8	2.4	3.1	2.8	2.8
CPI, year average, %	1.2	0.3	0.6	2.1	2.5
Official cash rate, year end, %	3.50	2.50	1.75	1.75	1.75
NZ$1 = US$, year average	0.83	0.70	0.70	0.72	0.75
US$1 = NZ$, year average	1.20	1.43	1.43	1.39	1.34
NZ$1 = A$, year average	1.09	1.07	1.07	1.08	1.09

Source: 2014-2016 data from Statistics NZ and NZRB; 2017-2018 forecasts by IMA Asia

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