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CONTENTS

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This report summarises the current business environment analysis and short-term forecasts of country directors running executive briefing programs across Asia. The Asia Pacific Executive Brief is owned and produced by International Market Assessment Asia Pty Ltd (IMA Asia).

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Global outlook

Strong global growth in 1H'18

… driven by the US

Watch for slower growth ahead

… + a rise in volatility & weak EM currencies

Global growth surprised on the upside in 1H'18, lifting Asia/Pac's export growth to 10.9%yoy in 1H'18 after a 10.4% rebound in 2017. However, the synchronised recovery across all 36 OECD economies and the main emerging markets that drove the 2017 rebound is fading. In its place is a surging US economy driven by a late cycle fiscal stimulus (the tax cuts, particularly for fixed investment). That's likely to see US inflation rise, as shortages of labour and materials build. Apart from Japan, which is briefly running hot, the picture in other big markets is muted. China is worried about growth slipping, as it clamps down on excess leverage and Europe's upturn, while good, is becoming less buoyant. One outcome is the US Fed's lonely march to higher interest rates, which means that the recent upswing of the US$ could accelerate in 2H'18. The three takeaways for Asia are to prepare for export growth to ease, to prepare for a rise in financial market volatility, and to watch for continued falls on a rising US$ for some Asian currencies, with the Philippines, Indonesia, and India being most exposed. The A$ and NZ$ are also exposed to falls, as their respective interest rate differentials with the US Fed rate have disappeared.

Trade wars

… US politics requires a quick resolution

… but rising nationalism stays

Strong, if lopsided, growth is not the story in newspapers, which are searching for the impact of US trade wars with Europe and China. So far that impact is sector specific and sporadic, although it could snowball. Our clients report two developments. One is the dumping of China goods that were bound for the US (but are now uncompetitive after new tariffs) into SE Asia from early July. The second is supply chain relocation for US-bound goods from China. Western MNCs are assessing alternative production sites and one client reports meeting a PRC firm that has moved production to India and is seeking all Indian materials. We expect some form of resolution of the current disputes in the next 6-8 weeks in time for US mid-term elections in November. However, commercial nationalism (mainly trade, investment, and technology) is on the rise and supply-chain restructuring will continue.

A surging US economy

… as tax cuts boost capex

Watch for rising interest rates and a strong US$

US growth lifted to an annualised 4.1% in Q2'18 on the preliminary release for quarter-on-quarter growth. On the year-on-year measure, the lift was a more modest 2.8%yoy, with strong growth in consumer spending (up 2.7%yoy) and combined (public + private) fixed investment (up 5.5%yoy). Strong domestic demand helped industrial production lift by 3.8%yoy at June from 1.6% growth for full 2017. Capex spending is running hot due to a revival in fracking and the Trump tax cuts, which include 100% immediate depreciation for any capex spending. That's left the Treasury with lower tax revenues and higher bond sales for Q3 to fund the budget deficit, which will push up interest rates. Inflation at June lifted to 2.8%yoy, which should justify another 1-2 rate hikes of 25 basis points in 2H'18 by the US Fed. Rising interest rates have helped lift the US$ by 4.2% on its major currency trade weighted index since January 1 (mostly in April-May). Goods imports for the first five months grew by 8.8%ytd, up from the 6.9% pace set for full 2017.

A milder Euro area upturn but strong import demand

Euro area growth has been slower than that of the US, but it has had a strongly positive impact on demand for goods from Asia. GDP data is available to Q1'18, with growth of 2.5%yoy thanks to a 3.6%yoy lift in fixed investment. Consumer growth was cooler than in the US, at 1.6%yoy in Q1'18. Moreover, consumer sentiment, retail sales growth, and new car registrations all eased in Q2'18. However, growth in goods imports for the first five months of 2018 was much stronger than in the US, with a 17%ytd rise after import growth of 9.7% for full 2017 (all US$ basis).

IMA Asia's forecasts	**2015**	**2016**	**2017**	**2018**	**2019**
World – Real GDP growth, %	3.5	3.2	3.8	3.9	3.9
- US	2.9	1.5	2.3	3.0	2.8
- Euro area	2.1	1.8	2.3	2.4	2.0
- Asia/Pacific (14)	4.5	4.7	4.9	4.7	4.9
- NICs (4)	2.2	2.6	3.2	3.0	2.5
- Developing or "EM" Asia (7)	6.7	6.6	6.6	6.4	6.3
- ASEAN (6)	4.5	4.6	5.2	5.0	4.8
World goods & services trade volume, % growth	2.8	2.3	4.9	5.1	4.7
Interest rates, US Fed target rate, year end, %	0.50	0.75	1.50	2.25	3.25
Inflation, CPI, US, year avg., %	0.1	1.3	2.2	3.0	4.0
Inflation, CPI, Euro area, %	0.0	0.2	1.5	1.5	1.6
Crude oil, avg of 3 spot crudes, US$	51	43	53	65	65
US$ / Euro 1, year average rate	1.11	1.11	1.13	1.24	1.21
Yen / US$1, year average rate	121	109	112	110	112

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, %	2015	2016	2017	2018	2019
Japan	1.4	1.0	1.7	1.0	1.1
China	6.9	6.7	6.9	6.5	6.3
Hong Kong	2.4	3.3	3.8	4.4	3.0
Taiwan	0.8	1.4	2.9	2.8	2.4
South Korea	2.8	2.9	3.1	2.7	2.5
Indonesia	4.9	5.0	5.1	5.6	5.7
Malaysia	5.1	4.2	5.9	5.0	4.6
Philippines	6.1	6.9	6.7	6.0	5.3
Singapore	2.2	2.4	3.6	3.6	3.0
Thailand	3.0	3.3	3.9	4.2	3.6
Vietnam	6.7	6.2	6.8	6.6	6.2
India (CY)	7.6	7.9	6.2	7.3	7.4
Australia	2.5	2.6	2.2	2.8	2.6
New Zealand	4.2	4.1	3.0	2.7	2.5

Inflation, CPI year average, %	2015	2016	2017	2018	2019
Japan	0.8	-0.2	0.5	0.6	0.9
China	1.4	2.0	1.6	2.1	2.6
Hong Kong (composite CPI)	3.0	2.4	1.5	2.5	3.0
Taiwan	-0.3	1.4	0.6	1.6	1.5
South Korea	0.7	1.0	1.9	1.6	2.4
Indonesia	6.4	3.5	3.8	3.3	4.0
Malaysia	2.1	2.1	3.7	1.3	2.3
Philippines	0.7	1.3	2.9	4.5	3.9
Singapore	-0.5	-0.5	0.6	0.5	1.3
Thailand	-0.9	0.2	0.7	1.0	1.4
Vietnam	0.6	2.7	3.5	3.7	5.0
India (CY CPI urban non-manual workers)	4.9	5.0	3.3	5.1	5.0
Australia	1.5	1.3	1.9	2.2	2.6
New Zealand	0.3	0.6	1.9	1.5	2.3

Exchange rate to US$1, year avg.	2015	2016	2017	2018	2019
Japan	121	109	112	112	116
China	6.28	6.64	6.76	6.60	6.86
Hong Kong	7.75	7.76	7.79	7.83	7.80
Taiwan	31.8	32.2	30.4	30.1	31.3
South Korea	1,131	1,160	1,129	1,104	1,148
Indonesia	13,389	13,309	13,381	14,002	14,435
Malaysia	3.90	4.14	4.30	3.97	4.05
Philippines	45.5	47.5	50.4	53.0	55.0
Singapore	1.37	1.38	1.38	1.34	1.38
Thailand	34.2	35.3	33.9	33.0	33.5
Vietnam	21,677	21,932	22,370	22,703	23,278
India (FY)	64.1	67.2	65.1	67.1	68.5
Australia	1.33	1.35	1.30	1.32	1.32
New Zealand	1.43	1.43	1.41	1.43	1.50

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

Regional outlook

Political & policy issues to watch

China eases its deleveraging campaign

… which will help 2H'18 growth

… restructuring of industry & the finance sector continues

Policy realignment in China dominates the region's outlook, as Beijing continues to drive deleveraging (mostly in real estate, construction, and local government) alongside massive restructuring of its industrial and financial sectors. Deleveraging in China means slower growth in China's capex, GDP, and imports, and that means lower global growth with weaker demand-side pressure on resource prices. However, July saw a slight easing in the deleveraging campaign, which is a plus for China's 2H'18 growth and for Asia's growth. The industrial restructuring is focused on reducing the role of low-value added and polluting industries and promoting the growth of high value-added industries. Apart from changing China's industrial landscape, it is pushing some industries - like furniture, clothing and footwear - into south and southeast Asia (garbage recycling is also being forced to relocate but has just been barred in Thailand). This is a plus for other emerging markets in Asia who can move up the low-end of the industrial value chain.

Elections loom for India & Indonesia, which will drive policy in 2H'18

India and Indonesia are less than year away from national elections. President Joko Widodo (Jokowi) in Indonesia and PM Modi in India are both under pressure to deliver on their election promises of reform-driven growth. Jokowi is putting the emphasis on a big infrastructure program. Modi would like to do the same, but his construction sector is bogged down in debt, so he is reverting to tax cuts and handouts. Fortunately, these look well timed for a cyclical upturn in growth. Both leaders are expected to win, although Modi faces a revived Congress-led opposition.

Tax reforms in Manila could slash investment incentives

Mid-term elections are also due in the Philippines next May, and that limits President Duterte's scope for further reforms. He'll give priority to getting TRAIN-2 passed, which is the second stage of his 5-stage overhaul of tax. That includes rationalisation of an array of tax incentives that helped win investment in business process outsourcing (BPO) and export processing zones where many MNCs have located. The battle over which incentives to cut will dominate Q3'18.

Outlook for the market

Strong exports in 1H'18 help lift Asia's local demand

… and that means a 2nd good year in 2018

With export growth for Asia/Pac lifting to 10.9%yoy in 1H'18 from 10.4% for full 2017 (US$ basis), the region is on track for a second year of strong growth. Asia stands out for its ability to drive growth equally from exports and local demand, and this year we'd expected the export engine to cool while local demand ran strong. Our growth forecasts are now edging up, as we find the export engine is running stronger than expected. That's led to tighter labour markets, which is boosting capex on new equipment and supporting a lift in consumer sentiment and spending. Key beneficiaries are Japan, China, and Taiwan in north Asia, but oddly not South Korea (and this may be due to massive offshoring of mobile phone production to Vietnam). Most of southeast Asia is gaining a similar benefit except for the Philippines, where significant export manufacturing has failed to establish.

Firm local demand should cushion the impact of weaker export growth in 2019

Global demand is set to ease in 2019, which means slower export growth for Asia (around 5% from 9% in 2018 and 10.4% in 2017) and slower GDP growth. However, the drop in GDP growth will be minor for most countries, as firm local demand should remain supportive of top-line growth. Our regional total growth rate stays at 3.9% in 2019, as we expect growth to lift in India, which has upside potential to 8% from our current forecast of 7.4%, and Indonesia, with more modest growth of 5.7% expected in 2019 after growth of 5.6% this year and 5.1% in 2017. Remember, 2019 is an election year in both countries, so governments will aim to ensure that growth lifts.

But Malaysia & the Philippines face a steady fall in growth

Two ASEAN economies face a steady slide in growth. The new government in Malaysia has stopped the constant voting-buying largesse of the defeated UMNO government. That means weaker consumer growth despite zeroing the GST on June 1. Capex growth will also slow, as all big projects are reviewed and then cancelled or postponed. A replacement of almost the entire top rank of the civil services will also slow decision-making. The Philippines is also slowing, with growth dropping from 6.7% last year to around 5.3% next year. The economy was overheating in 2016 and 2017, forcing inflation and the trade deficit up, and leading to a sharp fall in the Peso. Higher interest rates are needed and more cautious investors will contribute to slower growth.

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Japan

Political & policy issues to watch

PM Abe lines up party support for another 3-years

… while his popular support drops

PM Abe's short-term goal is a big win in the ruling LDP's internal election this September, which would give him a third 3-year term as party president. If he loses, he'd have to step down as PM; if he wins a narrow victory, then his dominance over the LDP's factions would crumble and his scope for policy initiatives would evaporate. That saw him risk extending the summer Diet session by an extra month to July 22 to push through bills important to key LDP power brokers, including a controversial bill to expand the number of upper house seats by six. Abe also pushed through an equally controversial bill to allow casinos at integrated resorts, which coalition partner Komeito was uncomfortable with. Passage of both bills knocked popular support for Abe to 45% in late July from 52% in late June. Abe's government will aim to regain ground before next spring's regional elections and next summer's upper house race. Provided Abe keeps a firm grip on the LDP in September, he should lead Japan to the 2020 Tokyo Olympics.

Pushing ahead on reform

… to labour laws

… & market opening via an EU trade deal

Next year's elections will test Abe's reputation as a reformer. The extended Diet session allowed Abe to pass eight labour related bills that cap overtime work for some workers (but not for high-paid white-collar staff) and require equal pay for equal work by regular and non-regular workers. Japan's outdated labour laws have been a major barrier to growth. A just signed Japan-EU trade deal should also come into effect in 2019 and will improve access to Japan's markets for EU dairy products and wine. Both sides also recognized each other's rules for data transfers and privacy protection as equivalent. The EU trade deal will bolster Japan, as it comes under pressure from the US for an unwanted bilateral trade deal. Japan would prefer the US to return to the Trans Pacific Partnership.

Outlook for the market

A great 2017 and a good 1H'18

… thanks to an export surge

… which lifted local demand

Japan has been a major beneficiary of the global trade recovery from late 2016. While a weaker Yen in 2017 helped, its factories are global leaders in the high-tech components that are in demand for mobile phones, ecommerce and IOT. That helped push export growth to 8.3% in 2017 (US$ basis) from an average pace of 3%pa for the prior 20 years and lifted the manufacturing component of industrial production by 4.5% in 2017 from zero average annual growth over the prior two decades. In turn, the labour market tightened, pushing up consumer demand, and profits at big companies soared on the back of better exports and offshore earnings. That dynamic remained firmly in place in 1H'18, with exports up 9.7%yoy. That should deliver GDP growth of around 1% this year, which is down from last year's 1.7% rise due to a weak Q1'18. 1% growth in 2018 is good for Japan as it is double the long-term trend GDP growth rate estimated by the Bank of Japan.

2 challenges lie ahead

… exports will cool

… & the Sept'19 sales tax hike

Two challenges lie ahead. We expect export growth to ease to 6% in 2H'18 and 3% next year. Some argue that the escalating trade war will also hurt exports. We're not sure, as Japan may gain from US-bound production exiting China for a base less exposed to US tariffs. The second challenge is the Sept 2019 sales tax hike to 10% from 8%. That will pull forward consumer and investment spending into Q1-Q3 2019 but will likely leave a recession for Q4'19 to Q2'20. We expect the government to announce stimulus measures for cars and housing to help counter the downturn. The sales tax bump, which repeats a pattern seen in 2014 (when the tax rose to 8% from 5%), should lift consumer spending growth to 1.5% in 2019 from 0.7% this year and 1% in 2017. It should also sustain capex growth at 1.2% in 2019 from 1.6% this year and 2.5% in 2017. Meanwhile, Japanese firms have accelerated their offshore drive, with overseas M&A deals jumping to Yen11.7tr (US$106bn) in 1H'18.

The BOJ sticks with QE and the Yen weakens

There's no sign of inflation and no reason for the Bank of Japan to end quantitative easing and its negative policy rate. That leaves the Yen easing against a rising US$, as interest rate differentials widen.

	2015	2016	2017	2018	2019
GDP, real growth (2005p), %	1.4	1.0	1.7	1.0	1.1
CPI, year average, %	0.8	-0.2	0.5	0.6	0.9
Overnight call rate, year end, %	0.04	-0.06	-0.06	-0.10	-0.10
Yen to US$1, year average	121	109	112	112	116

Sources: 2015-2017 data from the BOJ and government sources; 2018-2019 estimates by IMA Asia

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China

Political & policy issues to watch

A reset for President Xi Jinping

The last month has seen China back away from a wave of adulation for President Xi Jinping, which had built from the 19th Party Congress last November to the March 2018 NPC when a term limit on the state presidency was dropped. Xi posters are being taken down and he no longer dominates the front pages of the Peoples' Daily. It is possible that the party leadership thinks Xi overplayed China's hand in the China 2025 industrial strategy, angering trade partners and exposing China to Trump's trade war. If that's right, then China may pivot to a more acceptable path for trade partners after the party leadership returns from its annual summer beach party at Beidaihe. A mild reset for Xi mostly hints at a shift in policy rather than any diminution in Xi's political dominance. His second term as paramount leader runs to 2022/23, with a third 5-year term possible.

… and for economic policy

A reset on economic policy also emerged in July, although it had been widely anticipated from 2017 as the most likely step to cushion the pain of deleveraging in 2018. Tax cuts have been announced for small firms and local governments will be allowed to issue more bonds to fund infrastructure. China's central bank, the PBOC, is also easing liquidity with three cuts so far this year to the bank reserve requirement ratio and various other liquidity injections. This represents a partial easing – but not a reversal - in the deleveraging campaign that is one of Xi's signature economic policies. It fits within the narrative that in 2017 Beijing found it could fine tune growth for the first time.

… but not for industry policy

… although a deal on trade is expected

Beijing finds Trump's reality TV approach to running a superpower just as perplexing as America's allies. It would like to negotiate a deal to help curb the trade imbalance, open sectors of China's economy (as long promised but slowly delivered), and to improve intellectual property protection. That remains the most likely deal that will be reached in the next 6-8 weeks. While Trump will declare a gigantic victory, China's ambition for global technology leadership in key industries will not change and MNCs must figure out how to participate. Equally, the rise of economic nationalism appears entrenched, forcing MNCs to rethink global supply chains.

Outlook for the market

Deleveraging vs. a mild stimulus

… watch for GDP growth to slow

China's economy is slowing, as the deleveraging campaign eases capex growth and strong imports reduce the trade surplus (and thereby the GDP calculation). The trade spat with the US is hurting some supply chains, but it has not yet hurt GDP growth or export volumes. However, it may have encouraged Beijing to step up its stimulus effort in 2H'18. Our GDP growth forecast is unchanged from last month at 6.5% this year and 6.2% in 2019.

Exports, imports, and factory output

… all point to a strong 1H'18

… with growth to ease into 2019

China's export growth accelerated to 12%yoyin 1H'18 from 8% in full 2017 with the annual total at June of US$2.4tr breaking the prior record set in February 2015. That the 1H'18 trade balance fell 23%yoy to $144bn reflects a surge in China's imports, which rose 20%yoy in 1H'18 from 16% growth in full 2017. In short, China's export engine was as strong as ever in 1H'18, and the surge in imports suggests that local demand was strong too. Exports are, however, a small component of industrial output (about 15%). China's industrial production measure was up 6.7%yoy in 1H'18, slightly stronger than full 2017 (6.6%) and 2016 (6.0%). A cross-check to electricity production tends to confirm a strong 1H'18 for industry, with Q2'18 growth of 7.9%yoy, up from 6.0%yoy for 2H'17. We expect export growth to cool to 6% in 2019 from 11% this year and 8% in 2017. Import growth is expected to slow to 10% next year from 17% this year and 16% last year. The trade surplus will shrink from US$422bn in 2017 to under $300bn in 2019, with the current account surplus halving from 1.4% of GDP to around 0.7% for 2019. Industrial output growth should be about 6.6% this year and 6.2% next year.

The Yuan – not following the US$ up

As expected, Beijing has let the Yuan slip on a rising US$. From January 1 it has fallen 4.4% on the greenback, which has risen by 4.2% on its own major currency trade weighted index. Since the Yuan floated in 2005, it has risen 22% on the US$ to its current 6.81. A slip of 3-4% is likely in 2019, which matches our forecast for the US$ rise on its TWI.

	2015	2016	2017	2018	2019
GDP, real growth, %	6.9	6.7	6.9	6.5	6.3
CPI, year average, %	1.4	2.0	1.6	2.1	2.6
PBOC 1-year loan, at Dec., %	4.35	4.35	4.35	4.35	4.35
Yuan to US$1, year average	6.28	6.64	6.76	6.60	6.86

Sources: 2015-17 data from CEIC and government agencies; 2018-19 forecasts by IMA Asia

Hong Kong

Political & policy issues to watch

HK's government edges closer to Beijing

… with greater control over LegCo and district councils

Two years into her first 5-year term, Chief Executive Carrie Lam faces some key challenges: containing the risks in HK's soaring property market and accelerating HK's integration with the mainland. The latter may mean stepping away from the "one country, two systems" formula, which was meant to run to at least 2047 - and further restricting HK's already limited democracy. Recent developments seem likely to will help her. Last December, the pro-Beijing camp in the Legislative Council (42 of 70 members) pushed through rule changes that will limit pro-democrats filibustering bills. As a result, 27 bills have been passed so far this year, double the total of 2017. This lowers the risk of stalled bills halting major projects, illustrated by the quick passage of contentious legislation to allow China's passport control to operate in the high-speed rail terminus in HK. Earlier this month, the police proposed criminalising the tiny HK National Party, which pro-democrats fear could lead to more bans on other parties and candidates, just as the electoral commission recommended redrawing constituencies for the 2019 district council election that appears to handicap democrats.

The risk in soaring home prices

… house prices could start falling in 2H'18

Containing soaring property market prices probably will be even harder. By May, the residential property price index was up 15%yoy and by 260% from May 2010. The median apartment cost is 19 times the median pre-tax gross household income according to Demographia, creating risk for household balance sheets if the market falls. Lam's administration has tried to cool the market, by increasing land supply to developers and taxing empty apartments (often held by developers on an appreciation gamble). A growing number of local analysts now expect a mild price fall to start in 2H'18. The supply/demand balance still favours firm prices. But rising uncertainty and volatility in the global outlook could quickly turn that into a fall to match or exceed the 1997 collapse.

Outlook for the market

2018 will be a second year of strong growth

… as mainland tourists return

… offsetting weaker trade

HK's GDP growth accelerated to 4.7%yoy in Q1'18 thanks to firm global demand, a strong Chinese economy, and to a 12.5%yoy jump in mainland visitors, which ended a painful slump from 2015 to 2017. Trade growth (combined imports and exports in US$) rose to 9.2%yoy in Q1'18 from 7.9% for full 2017 and likely exceeded 10%yoy in Q2'18. As mainland arrivals were also likely stronger in Q2'18, first half GDP growth should match or better Q1'18, which is well above the government's projected 2018 growth of 3-4%. Our 4.4% forecast for 2018, followed by 3% for 2019, assumes trade growth slows from 8% in 2017 and 2018 to 3-4% in 2019, that the fall in house prices is mild, and that damage from a trade war is limited. By June, the local PMI had been falling for four straight months, with a reading of 47.7 hinting at a faster drop in growth than we expect in 2H'18.

China tourists lead to a surge in retail sales

The rebound in mainland arrivals lifted retail sales growth to 14%ytd by May from just 2.2% for 2017. Apparel was up 13%ytd (from 1% for 2017), department store sales increased 14%ytd (3% for 2017), and the valuables category (jewellery, watches etc) jumped 23%ytd (5% in 2017). Supermarket sales, which tend to track local consumer spending, rose 1.5%ytd by May, after zero growth in 2017 and 1% in 2016. We expect real growth in consumer demand of 6.6% this year and 3% in 2019, from 2.5% in 2017.

Fund inflows keep interest rates low & the HK$ weak

The market is awash with liquidity (partly overseas funds arriving to take part in large IPOs), which has pushed HIBOR below LIBOR and allowed local banks to delay lifting mortgage rates even though the local central bank has followed lock-step with US Fed rate hikes. High HK$ liquidity has push the HK$ to the lower limit of its 7.75-7.85 trading band

	2015	2016	2017	2018	2019
GDP, real growth, %	2.4	3.3	3.8	4.4	3.0
Composite CPI (14/15), year average, %	3.0	2.4	1.5	2.5	3.0
Discount window base rate, % year end	0.75	1.00	1.75	2.50	3.25
HK$ to US$1, year average	7.75	7.76	7.79	7.83	7.80

Sources: 2014-2017 from Censtat, HKMA, and CEIC; 2018-2019 forecasts by IMA Asia.

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Taiwan

Political & policy issues to watch

Taiwan's shifting identity plays big in local politics

… watch local elections in November, which could boost the DPP

Four months from November's local elections, the key question in whether a swing away from the KMT, which ran Taiwan as a dictatorship from 1945 to 1987, and towards the DPP will continue. In 2016, the DPP won the legislature for the first time and (for the second time) the presidency. While support for President Tsai Ing-wen has fallen as she pushed through unpopular policies, the DPP still has momentum on its side thanks to two developments. One is the emergence of a Taiwanese identity among younger voters in place of the KMT's rigid adherence to a national Chinese identity. The second is the ongoing revelation of repression and theft during the KMT's dictatorship. Former KMT head and Taiwan president Ma Ying-jeou has just been indicted for his role in trying to hide some of the KMT's plundered assets. On present trends, the DPP (pan-Green to the local media) should continue to push out of its stronghold in southern Taiwan into the pan-blue KMT stronghold of northern Taiwan, which includes Taipei. That should help President Tsai win a second 4-year term in 2020.

It's also a big factor roiling ties with China

… but that may be put aside as a trade war looms

None of the above is welcome to Beijing, which detests the DPP and would prefer a KMT-led government. Accordingly, China has cranked up diplomatic and military pressure to force Taiwan into line, which accounts for a rise in political risk ratings for Taiwan (including our own). US President Trump has been a wild card for both sides, but broader US administration and military backing for Taiwan appears to be rising. That includes a recent proposal to the US National Guard Association to extend membership to Taiwan's Armed Forces Reserve Command. Fortunately, China has avoided applying commercial pressure, as cross-straits business ties are vital to both sides. Such pragmatism will be more important as firms search for alternative US sourcing as a trade war escalates.

Outlook for the market

A 2017 rebound and a strong 1H'18

… with firm exports and a lift in consumer demand

After 13% export growth in 2017 (US$ terms), Taiwan racked up 11%yoy growth in 1H'18 underscoring continued strong export momentum even though a number of indicators suggest the pace will cool in 2H'18. By May, the manufacturing part of the industrial production index (IPI) was up 5.5%ytd from 5.3% growth in 2017. We expect export growth to slow to 7%yoy in 2H'18, putting the full year at just under 9% growth with 6.5% expected in 2019. That will see manufacturing output growth (on the IPI) slow to 2.5% next year from 4.9% this year and 3.7% in 2017. The strength of export manufacturing over 2017 and 2018 has caught us – and local manufacturers - by surprise, leading to a scramble for components and skilled factory workers this year. Even though wage growth is weak, that's boosted consumer confidence, which helped lift retail sale by 3%yoy in 1H'18 after three straight years of growth around 0.5%pa. We've lifted our 2018 GDP growth forecast to 2.8% (prior 2.4%) with 2019 rising to 2.4% (prior 2%).

Taiwan's ride through a rising trade war

… tough at first but it may gain by 2019

Taiwan is a big player in the global supply chain that runs through China to the US. Some argue that means Taiwan will take a big hit as a China-US trade war escalates even though Trump has avoided tariffs on the iPhone (the single biggest product behind the US trade deficit with China and a key driver of Taiwan's IT sector). A negative impact is possible in Q3'18, but by Q4'18 some small firms may shift some production back to Taiwan. Foxconn has a different problem as it has bet big on China as its global assembly base while Samsung has bet on Vietnam. There are few options for relocating such a massive operation, and the US$10bn investment in a new US plant is one.

The NT$ slips on a rising US$

Inflation lifted to 1.6%yoy for 1H'18 but with growth easing over the next year we don't expect it to go higher. Since April, the NT$ has given ground against a rising US$, falling to 30.5 through most of July. With growth cooling, Taiwan's central bank is unlikely to lift its policy rate, which leaves the NT$ on a mild slide as US interest rates and the US$ rise.

	2015	2016	2017	2018	2019
GDP, real growth, %	0.8	1.4	2.9	2.8	2.4
CPI, year average, %	-0.3	1.4	0.6	1.6	1.5
Official discount rate, year-end, %	1.63	1.38	1.38	1.38	1.38
NT$ to US$1, year average	31.8	32.2	30.4	30.1	31.3

Sources: 2015-2017 government data and CEIC; 2018-2019 forecasts by IMA Asia.

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South Korea

Political & policy issues to watch

President Moon

… has won more support in the legislature

President Moon Jae-in is 14 months into his single 5-year term (to May 2021). His success with North Korea helped his left-of-centre Democratic Party (DPK) win a landslide victory in June 13 local elections, which included picking up eight National Assembly seats from 12 concurrent by-elections. While DPK's 130 seats are short of a majority in the 300-seat body, the assembly has just passed the mid-point of its 4-year term (to April 2020), which means that the leadership of the 18 standing committees has been redistributed. The DPK won the speakership plus chairs for eight committees (including the powerful House Steering Committee), which puts it in a good position to pass Pres. Moon's agenda. Minor parties on the left may soon form a coalition with DPK to deliver a legislative majority.

Controversial hikes in the minimum wage

Central to Moon's legislative agenda is reviving local demand by big increases in the minimum wage. The 2018 increase was 16.4% to Won 7,530 (US$6.82/hour) and the 2019 increase has just been set at 10.9% to Won 8,350 ($7.28). That sparked a backlash from firms but also dissatisfied Moon's left-wing supporters, as Moon was forced to give up his campaign promise of a Won 10,000 minimum hourly rate by 2020. The minimum pay hike should support consumer demand, but also encourage more offshoring by big firms. Moon also wants to deregulate markets and has recently targeted the barriers to foreign products with new technologies (notably medical devices).

Better ties with N Korea and with China

Moon's administration is pressing ahead for better ties with North Korea. After a 10-year break, South Korea has sent an inspection team to look at opening railway lines through North Korea, which would likely entail complete rebuilding. Critically, better relations with Pyongyang will lower barriers in China for South Korean firms. South Korea's exports to China jumped 21%yoy in 1H'18 against a 7.0% rise for all exports (US$ basis).

Outlook for the market

Growth ebbs as exports weaken

The Bank of Korea (BOK) has just cut its 2018 GDP growth forecast to 2.9% from 3%, as export growth slowed to 3.5%yoy in Q2'18 from 10.1%yoy in Q1'18 and 15.8% in full 2017. That saw manufacturing fall 1.4%ytd by May after rising 1.5% in 2017, while employment growth also slowed, and growth in the leading composite index eased to 3.6%yoy by May from a 6.1%yoy peak in July 2017. Our 2018 GDP growth forecast is lower that the BOK's at 2.7%, and we expect growth to ease to 2.5% in 2019 from 3.1% in 2017.

Firm consumer demand

… except for big-ticket items

Consumer demand is holding up, despite the employment slowdown. Consumer goods imports (US$-based) grew 14.5%yoy in Q2'18 from 16%% in Q1'18 and 9.2% in 2017, as wages rose 7%ytd by April after a 2.7% rise in 2017. However, elevated household debt (equal to 95% of GDP) has cut sales of big-ticket items (car sales fell 2.1%yoy in 1H'18 after a 3.5% drop in 2017), while household credit growth slowed to 7%yoy in May from a 13%yoy peak in April 2016. We expect consumer real growth to ease to 2.5% in 2019 from 3.1% in 2018 and 2.6% in 2017.

Weaker capex activity

… for plant and construction

A slump in growth for capital goods to 1.2%yoy in Q2'18 from 12.7%yoy in Q1'16 and 16.2% in 2017 paints a weak outlook for fixed investment. Capex fell 1.1%yoy in Q2'18 after its growth slowed to 3.5%yoy in Q1'18 from a 10.8%yoy peak in Q1'17, as plant & equipment and construction activity cooled. These are set to cool further, as the global electronics up-cycle matures, and construction permits are retreating from their 2016 highs. We expect capex growth of 2.5%pa in 2018-19 from 8.6% last year and 5.6% in 2016.

Won weakness to extent into 2019

Low inflation (1.4%yoy in 1H'18) and weaker demand should allow the BOK to keep its policy interest rate at the current 1.50% well into 2019. After a 16.2% climb on the US$ from January 2016 to January 2018, the Won entered a weakening trend on a rising US$.

	2015	2016	2017	2018	2019
GDP growth, %	2.8	2.9	3.1	2.7	2.5
CPI, year average, %	0.7	1.0	1.9	1.6	2.4
BOK Base rate, year-end, %	1.50	1.25	1.50	1.50	1.75
Won to US$1, year average	1,131	1,160	1,129	1,104	1,148

Sources: 2015-2017 government data (NSO, BOK) and CEIC; 2018-2019 forecasts by IMA Asia.

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Indonesia

Political & policy issues to watch

A good outcome from June's local elections

The June 27 regional elections had two positive messages: radical Islam, which dominated in the 2016 Jakarta elections, failed to have an impact; and candidates aligned with President Joko Widodo (Jokowi) did well. Candidates ran on their personalities and group affinities, with no policy platform beyond continuing Indonesia's inward-looking economic policies, driven by state-owned enterprises and heavily-subsidized social policies.

Pres. Jokowi is set to win a 2nd term in 2019

The stage is now set for the 2019 presidential race in which President Jokowi will seek a second 5-year term. This could come down to a one-horse race, as rules stipulating high minimum support levels combine with a tendency for parties to align with the likely winner in the hope of gaining a few cabinet seats. Jokowi is backed by six parties and they appear to have agreed on his vice president, who will be announced as registration closes on August 10. His main opponent (as in 2014) is Prabowo Subianto, who has yet to cobble together a coalition that meets the threshold support requirement.

At last a deal on Freeport's big mine

… that helps Jokowi

… but can resources nationalism work?

Freeport-McMoRan and the government have finally struck a deal on handing majority control of the Grasberg mine to Indonesia. While closing the deal should take another six months, it will bolster Jokowi's position in Indonesia's intensely nationalistic political contest. Grasberg is the world's second largest copper mine and one of Indonesia's biggest exporters and employers. State-backed PT Inalum will pay US$3.9bn to lift Indonesia's stake to 51% from 9% (by buying out Rio Tinto). Freeport with retain 49% and continue to operate the mine until 2041, as its technology is critical to the mine's next phase of underground development. Markets judge the deal a poor one for Freeport; hopefully, Indonesia will quickly close the deal without quibbling. We will then see if Inalum can successfully partner with Freeport and manage the red tape that has forced other foreign miners to exit. Indonesia's SOEs have a poor operating reputation, with national oil company Pertamina about to sell assets to avoid a financial crisis.

Outlook for the market

Growth lifts in mid-2018

… thanks to firm exports

… & a recovery in consumer demand

After four years of being stuck near 5% growth, the economy is set to lift in 2H'18 on continued good exports and a mild acceleration in local demand. Export growth dipped to 8.8%yoy in Q1'18 from a 16% rebound in 2017, but then lifted to 11.4% in Q2'18 (based on US$ values). Imports (excluding oil and gas), which are a pointer to local demand, surged 24%yoy in 1H'18 from 13% growth in 2017. Motorcycle sales, which plunged 25% from 2014 to 2017 as one of the biggest pointers to a consumer pullback after fuel subsidies were cut, climbed 11%yoy in 1H'19. The construction sector also looks stronger with cement sales up 8.5%yoy in 1H'18, not far off the 9.6% rebound in 2017. We've nudged up our 2018 forecast to 5.6% (prior 5.4%) with 2019 lifting to 5.7% (prior 5.5%).

Mid-2018 bonuses for civil servants help lift spending

… & civil works sustain capex growth

Jokowi gave the consumer recovery a nudge by lifting the June Idul Fitri holiday bonus and the July 13-month payment for some 4.5m civil servants (covering some 4% of the working age population). The finance ministry puts the cost at $2.5bn, up 70% on 2017. Retail sales growth, which slumped to 3% in 2017 and just 0.7%yoy in Q1'18, rebounded to 6.4%yoy in Q2'18. We expect consumer spending to lift 5.2% this year and 5.7% in 2019 from 4.9% in 2017. Meanwhile, the government's big infrastructure program should keep capex growth at 7-8% in 2018 and 2019 from 6.2% in 2017.

Mild inflation and a contained slip for the Rupiah

Inflation eased to 3.3%yoy in 1H'18 from 3.8% in 2017 and is not expect to rise until 2019. Despite that, the central bank lifted its policy rate by 100 basis points from May to June to defend the Rupiah, which has been pushed down 3.5%yoy on a rising US$ in 1H'18. We don't see grounds for further depreciation unless the US$ jumps. A 4.5% fall is likely in 2018, with the June rate of 14,049 close to the expected average 2018 level.

	2015	2016	2017	2018	2019
GDP, real growth, %	4.9	5.0	5.1	5.6	5.7
CPI, year average, (2012=100), %	6.4	3.5	3.8	3.3	4.0
Central bank rate (7-day RR) at Dec %	6.25	4.75	4.25	5.50	6.00
Rupiah to US$1, year average	13,389	13,309	13,381	14,002	14,435

Sources: 2015-2017 government data (BPS, BI) and CEIC; 2018-2019 forecasts by IMA Asia

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Malaysia

Political & policy issues to watch

The new PH-led government

… how much will change under PM Mahathir?

… will he hand power to Anwar?

One observation and one question stand out two months after the first opposition victory in Malaysia since independence in 1957. The observation is that local political pundits and voters are both delighted to be rid of PM Najib Razak's government, which was mired in corruption. While the political honeymoon may be short-lived as policy challenges loom, the landslide rejection of the last government should allow the Pakatan Harapan (PH) coalition government to run most of a full 5-year term (it can pick its next election date). The overriding question is how much will change? PM Mahathir (93), who heads the government, allowed many of the ills of the prior government to emerge when he first led Malaysia over 1981-2003. Moreover, he has promised to hand over government to Anwar Ibrahim after two years. Such handshake deals are high risk in any democracy. Anwar, the de facto head of PKR, which led the PH coalition to victory, is expected to replace his wife as PKR head in a party vote in August. If he is then to replace her as Deputy-PM (and eventually as PM), he must win a parliamentary seat in a by-election.

Assume a 2-stage government

… some stable cleaning & policy reversals

… followed by a big reform agenda

Our best answer to how much will change is to assume a 2-stage PH government. In his two years, PM Mahathir will clean out the stables and reverse the unpopular policies of the prior government. The latter include a string of harsh security laws, opaque infrastructure deals with Chinese firms, and the 6% GST introduced in 2015 and widely blamed for higher prices. All big projects are being reviewed with the aim of scaling them down or cancelling them to curb a jump in public debt. The GST went to zero on June 1 and will be replaced with the old sales and services taxes from September 1. The government has also halted migrant worker schemes with Bangladesh (up to 1.5m workers) and Nepal (up to 500,000) that generated big payments to UMNO politicians. That may mean labour supply problems for the large plantation sector. A guide to the policies that Anwar might pursue if he becomes PM in 2020 is set out in the 60 promises made during the campaign.

Outlook for the market

Rising headwinds to cool growth in 2H'18

Malaysia's growth is set to slow to 5% this year and around 4.6% in 2019 from 5.9% in 2017, as export growth eases, big projects are put on hold, public spending is trimmed, and consumers pull back. The risk to our forecast is on the downside, particularly for consumer spending, as household debt has risen sharply and many households face an end to government payments to buy their political support. A second challenge is whether private capex growth can be sustained, as almost all big projects in Malaysia have a political dimension in which excessive dependence on China was only one of many issues.

After strong growth in 1H'18

… driven by an export surge

Fortunately, 2018 started with a 20%ytd surge in exports to May (US$ basis), up from 15% growth in 2017. That lifted the trade surplus, kept manufacturing growth at 5%ytd by May from 6% for 2017, and pushed employment growth to 2.8%yoy in May from 1.8%yoy in May 2017. Along with the election outcome, that has triggered a surge in consumer confidence. Looking forward, we expect export growth to halve to 9-10%yoy in 2H'18 with 6% growth in 2019. That will see growth in the industrial production measure for manufacturing cool to around 5% this year and 4.5% next year.

Watch for weaker consumer & capex demand

With export manufacturing slowing, big projects on hold, and an overbuilt housing market correcting, we expect fixed investment growth to fall from 6.2% in 2017 to 1.5-2.5%pa in 2018-19. Meanwhile, real growth for consumer demand is expected to ease to 5.5% in 2019 from 6.3% in 2018 and 7.0% in 2017.

And a M$ surge on the US$ to halt

While zeroing the GST cuts inflation in 2018, introducing the SST will help push it back up to 2.3% in 2019. That's mild, and with external and local demand cooling Bank Negara should keep its policy interest rate at 3.25% level well into 2019. That should help drive the M$ lower by 1.5-2.0% against the US$ next year.

	2015	2016	2017	2018	2019
GDP, real growth, %	5.1	4.2	5.9	5.0	4.6
CPI, year average (2010=100), %	2.1	2.1	3.7	1.3	2.3
Central bank overnight policy rate, Dec, %	3.25	3.00	3.00	3.25	3.50
Ringgit to US$1, year average	3.90	4.14	4.30	3.97	4.05

Sources: 2015-2017 data from government, Bank Negara, & CEIC; 2018-2019 forecasts by IMA Asia.

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Philippines

Political & policy issues to watch

A headwind for Pres. Duterte as mid-term polls approach

President Duterte is two years into his single 6-year term and has had good support for his bills in Congress. But with mid-term elections looming next May, the window for legislation is closing fast. High on the list of must-pass bills are those for stage two of Duterte's five-stage tax reform ("TRAIN-2"). Duterte ally (and Philippines president for 2001-10) Gloria Macapagal Arroyo has just taken over the house speaker's chair and should do a good job of focusing congressmen on passing TRAIN-2. After a long run of strong opinion poll support, June saw Duterte's approval rating hit a new low of 45% (on the SWS poll) after he attacked the Catholic Church. He'll need to mend fences with the church and lift his approval rating to 50%+ or his support in Congress for key legislation will crumble.

That may slow or halt stage 2 of tax reform

TRAIN-2 aims to cut the corporate rate to 25% from 30% and rationalise tax incentives. It is that second goal that will make its passage difficult, as firms that did well from tax breaks (like the BPO sector and those in export processing zones) argue that TRAIN-2 will force investment overseas and boost unemployment. As that argument is made in every country that tries trimming incentives, this will become a test of the administration's capacity to sell its agenda and to mobilise support – both critical skills for any reformist government.

A chance for better security & peace in the south

Duterte does have a record of passing bills that prior governments couldn't. That includes the Bangsamoro Organic Law, which could end the insurrection in the Muslim-dominated south of the country by devolving a high degree of autonomy. If successfully implemented, that would improve the Philippines' security profile and boost national growth.

Outlook for the market

Slower growth with less risk into 2019

Rising inflation, a fast-growing trade deficit, and big falls for the Peso (-6.4%ytd) and the local stock market (-13.8%ytd) point to an overheated economy in 1H'18 and rising macro risk. Fortunately, the surge in local demand growth that triggered those problems is easing and the central bank has belatedly started monetary tightening. We expect that to trim GDP growth to 6.0% this year and 5.3% next year from 6.7% in 2017. Domestic demand will also cool from 6.4% this year to 5.3% in 2019 from 6.9% in 2017. That should help lower inflation next year and help slow the currency's fall on a strong US$.

As a surge in capex and construction eases

Fixed investment hit a record high share of GDP at 29% in 2017 from 20% in 2012, underscoring its role as the economy's main growth driver on the back of a big expansion in infrastructure spending. That capex surge led to higher inflation, a bigger trade deficit, and a falling Peso. Fortunately, capex growth slowed to 9.5% in 2017 after soaring 26.1% in 2016. We expect further slowing to 7.5% this year and 5.5% in 2019, as interest rates rise and construction cools.

Consumers have also pulled back as prices jumped

… but China tourist arrivals surge

Despite strong GDP growth, consumer sentiment fell over the last nine months, as rising prices cut household spending power. Some of the price rises were due to tax hikes under the first stage of Duterte's tax reforms and some were due to a weak Peso pushing up the cost of imported goods. Consumption real growth eased to 5.9% in 2017 from a multi-decade high of 7.1% in 2016. We expect it to slide to 5% in 2019 from 5.3% in 2018. Surging China tourist flows are starting to become a factor, with 44% growth for the year to May, taking their share to 16% of all tourists from 7% in May 2015. That inflow has contributed to a surge in the casino sector in Manila and apartment projects targeting middle class Chinese.

Higher interest rates will slow the Peso's slide

After inflation hit 5.2%yoy in June from 1.3%yoy in June 2016, the central bank reluctantly lifted its policy interest rate to 3.50% from 3.00%. More rate hikes are likely into 2019 and that should help slow the pace of Peso's decline on the US$ to 3-4%pa from 5.8% in 2017.

	2015	2016	2017	2018	2019
GDP growth, %	6.1	6.9	6.7	6.0	5.3
CPI, annual average, %	0.7	1.3	2.9	4.5	3.9
Central bank reverse rep. rate, year end	4.00	3.00	3.00	4.00	5.00
Peso to US$1, annual average	45.5	47.5	50.4	53.0	55.0

Sources: 2015-2017 data from BSP and CEIC; 2018-2019 forecasts by IMA Asia.

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Singapore

Political & policy issues to watch

Watch for a smooth change in leadership by 2021

Three senior cabinet members - Finance Minister Heng Swee Keat, Education Minister Ong Ye Kung, and Trade & Industry Minister Chan Chun Sing - are lining up to succeed PM Lee Hsien Loong, who plans to step down before the next election, which is due in early 2021. The next PM will be the fourth since Singapore became independent in 1965. We expect a smooth leadership transition in line with the ruling PAP's long-standing practice of well-telegraphed changes. The new leadership will face big challenges arising from Singapore's rapidly ageing population (that prompted plans to lift the GST rate to 9% from 7% sometime between 2021 and 2025 to fund social services), China's rise as a regional superpower, and Malaysia's newly elected government led by PM Mahathir Mohamed. The PAP has led Singapore since the 1959 general election, winning all 13 subsequent general elections, including 2015 (with 70% of the vote and 83 of 89 contested seats). While PAP's vote might slip under a new leader, it should remain dominant.

Malaysia's call to postpone the high speed rail link

The outlook will partly depend on how well Singapore does at smoothing key foreign relationships. First up is renogitating the high-speed rail link to KL with the new Malaysian government, which wants to defer the project after Singapore has started work. PM Mahathir was never an easy partner for Singapore, and if talks break down, vital links could be affected (e.g. Singapore gets 58% of its daily water supply from Malaysia at M$0.03 per 1,000 gallons, a price Mahathir finds unacceptably low).

Outlook for the market

A surge in export manufacturing from late 2016

… should cool into 2019

… with a weak recovery for construction

Singapore's economy has three giant engines: manufacturing (19% of GDP and with factory exports more than double that of Indonesia or the Philippines), services (67% of GDP), and construction (just 4% of GDP, but on a per capita basis equal to Japan). Since Q4'16, the manufacturing sector has surged on a strong global recovery, with average real growth of 10%yoy for seven straight quarters to Q2'18. But over that same period construction fell by an average 7%yoy due to real estate cooling measures, while services grew at a milder 3%yoy average. So, with one engine in top gear (manufacturing), one in reverse (construction), and one in second gear (services) the net outcome for GDP was a mild lift to 3.6% growth in 2017 and 4.1%yoy in 1H'18. Looking forward, we expect manufacturing growth to cool to 6-7% this year and 3-4% in 2019 from 10.1% in 2017, while construction growth lifts to 3% in 2019 after a fall of 2-3% this year and 8.4% in 2017. Services growth should lift to 3.5% this year and 3.2% in 2019 from 2.8% in 2017.

Capex jumps on plant & equipment

… with a mild lift for civil works

The steep construction fall meant that fixed investment declined by an average 1.4%yoy over the seven quarters to Q2'18. (we've estimated the most recent quarter). Yet with manufacturing surging, capex on plant and equipment swung from four quarters of decline to the three quarters to Q2'18 with average growth above 10%yoy, as factories geared up to meet strong demand. The outlook for construction capex dimed in July, after stamp duty hikes on real estate purchases and new mortgage restrictions aimed at halting a surge in home prices. Earlier restrictions contributed to a mild slide of home prices in the four-years to mid-2016, but prices have jumped 9% since then. To help cushion the slowdown in private capex, public investment in civil works is likely to grow 1.7% in 2018 and 2.7% in 2019 from -1.8% in 2017.

Steady consumer demand on strong employment

Consumer demand should grow faster than GDP at 3.7% in 2018 and 3.5% in 2019, as employment growth gradually picks up after a 0.2% dip in 2017 and the resident unemployment rate stays low at 2.9% in 1H'18. With wages growing well above inflation (4%yoy in Q1'18 from 3.0% in full 2017), ex-car retail sales rose 2.3%ytd by May compared to a 1.9% increase in full 2017.

Low inflation and a soft S$

With inflation falling to 0.3%yoy in 1H'18, a mild tightening in monetary policy by the MAS (Singapore's central bank) last April appears premature. After an 8% gain on the US$ through 2017, the S$ joined the retreat of most currencies against a resurgent greenback. This is likely to continue into 2019, as interest rate differentials favour the US$.

	2015	2016	2017	2018	2019
GDP, real growth, %	2.2	2.4	3.6	3.6	3.0
CPI, year average, %	-0.5	-0.5	0.6	0.5	1.3
3-month interbank interest rate, Dec, %	1.19	0.97	1.50	1.53	1.55
S$ to US$1, year average	1.37	1.38	1.38	1.34	1.38

Sources: 2015-2017 data from government, MAS and CEIC; forecasts for 2018-2019 by IMA Asia

Thailand

Political & policy issues to watch

The military aims for a tightly controlled 2019 election

… leading to a military-guided government

The military junta that has run Thailand since 2014 continues to talk of elections in 2019 that will install a military-guided government. February was once suggested, but recently PM Prayut (who led the coup) has said it shouldn't take place until the new King has been crowned, and no date is set for that. Meanwhile, parties have been allowed to reform and register for the contest, but bans on more than five people meeting or any campaigning will remain in place, apparently until Q4'18. PM Prayut has also taken his cabinet on a tour of northeast Thailand promising big infrastructure projects and handing out money. This is the heartland of the Pheu Thai party founded by ex-PM Thaksin (and the winner of every election since 2001). Key Pheu Thai regional leaders (or the power brokers who control them) are being paid to switch camp to pro-government parties. Such effort suggests that the military is serious about holding an election sometime in 2019.

Political risk will rise under rigid army control

A 20-year National Strategy Act has just been pushed through the rubber-stamp National Legislative Assembly. In our view it raises the long-term political risk for Thailand. It puts a military-stacked, 35-member National Strategy Committee (NSC) and a pro-junta anti-corruption commission in a position to punish any politician who breaks with the NSA plan for Thailand over the next two decades. Such a rigid framework is likely to bottle up political and policy tensions with the risk that they build into a crisis.

Outlook for the market

Growth lifts in 2018

… on strong exports and a consumer revival

Thailand's export manufacturing sector had a good start to 2018. Exports grew 11%yoy in 1H'18 after a 10% rise in full 2017 (US$ basis), which helped lift industrial production growth to 3.8%ytd by May from 2.5% in 2017. We've lifted our full 2018 export growth forecast to 9% followed by 6% in 2019, while industrial production is now expected to grow 3.5% this year and 3% in 2019. Local demand also improved, with the local consumption index (a volume or real growth measure) up 3.9%ytd by May from 2.6% for 2017. Fixed investment activity picked up, with 3.8%yoy growth in Q1'18 after a 0.9%yoy increase in 2017. We've lifted our 2018 GDP growth forecast to 4.2% (prior 3.7%) and that of 2019 to 3.6% (prior 3.2%).

A winner in a US-China trade war

… FDI inflows recover

Two big assumptions underline our optimistic outlook. The first is that Thailand won't be hurt by the building trade war. Our latest talks with clients note some dumping into Thailand from China has started, but so too has some reallocation of export production. We also assume that short-term political risk is modest (despite our long-term concerns). That seems to be the signal from net foreign direct investment (FDI) inflows, which hit an annual rate of US$10bn in April, well above 2017's $8bn haul and 2016's $3bn.

A tight labour market & surging China tourists boost consumer demand

Vehicle sales provide a quick read of consumer strength in 1H'18. Sales of the all-important, 1-tonne truck rose 18%yoy in 1H'18 from 8% in full 2017, while passenger car sales growth cooled to 18%yoy in 1H'18 from 24% for 2017. SUV sales jumped 56%yoy in 1H'18, after rising 11% in full 2017. The labour market has tightened considerably since 2H'17, with 2.5 registered vacancies for every registered job applicant. We expect real growth in consumer demand to lift to 3.8% this year and next from 3.2% in 2017 and an average 2.4%pa for the decade to 2016. That lift will be helped by a surge in China tourist arrivals, up 26%yoy in 1H'18 to account for 29% of all arrivals from just 10% for the year to June 2012.

The Baht falls on a rising US$

Inflation was up 1.4%yoy in June, at the low end of the central bank's 1-4% target range. That will allow the Bank of Thailand to avoid any rate hike well into 2019. The growing interest rate gap with the US Fed rate halted the Baht's uncomfortable climb from 36 to US$1 in December 2016 to 31 this March. By end July, the Baht had eased to 33 and we expect it to stay at that level or weaker (if the US$ climbs) through 2019.

	2015	2016	2017	2018	2019
GDP, real growth, %	3.0	3.3	3.9	4.2	3.6
CPI (2002 index), year average, %	-0.9	0.2	0.7	1.0	1.4
Central bank, policy rate, year end, %	1.50	1.50	1.50	1.50	1.75
Baht to US$1, year average	34.2	35.3	33.9	33.0	33.5

Source: 2015-2017 data from BOT and CEIC; 2018-2019 forecasts by IMA Asia.

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Vietnam

Political & policy issues to watch

A stable communist government

… occasional protests, notably over China

Communist Party head Nguyen Phu Trọng (74) has led Vietnam since 2011 and gained a second 5-year term in January 2016 after pushing aside a challenge from then-PM Nguyen Tan Dung. A Trong supporter, Nguyen Xuan Phuc, took over as PM in April 2016 for a 5-year term to lead the administration; meanwhile, Dung's supporters have been purged from key positions as part of an anti-corruption campaign. That leaves Trong and the Communist Party with a firm grip on power. Unlike China, however, political control is not pervasive, and there are minor protests over corruption, lack of transparency, little political reform, and growing ties with China. This last issue saw street protests in June delay a plan to give foreign firms, including those from China, 99-year land leases.

With pro-market policies & gradual reform

While Dung may have moved faster on reforms if he'd won power, Trong has consistently supported economic reform. The gains are apparent in the IMF's latest country report, which sees trend growth of 6.5%pa to 2023. The IMF report is an essential read for any firm doing business in Vietnam or planning entry.

A controversial cybersecurity law

… & confused automotive policy

The clash between political conservatism and pro-market reforms is prominent in a new cyber-security law, which goes into effect next January 1. Among other things, it requires companies to store data on local users within the country and share that data with the government, which would be tricky for firms such as Facebook and Google. Meanwhile, the automotive sector is grappling with a surge in non-tariff barriers after Vietnam moved to zero tariffs for vehicles imported from other ASEAN countries on January 1. That saw new car sales fall 6%yoy in 1H'18 and left an uncertain outlook for a key industry.

Outlook for the market

A mild slowdown as exports and construction growth cools

Vietnam faces a mild slowdown over the next 18 months, as growth eases in export manufacturing on weaker global demand and a construction surge cools. That will help contain the risk of overheating and shouldn't upset growth in a fast-rising consumer market. Real growth for manufacturing is expected to ease to about 11% this year and 9% next year from an average 12.3%pa over 2015-17. Construction growth is expected to ease to around 7%pa in 2018 and 2019 from 9.8%pa for 2015-17. Meanwhile, consumer growth should stay around 7-7.5% this year and in 2019 from 8%pa over 2015-17. The overall GDP result for 2018-19 will remain close to the 6.6%pa pace set over 2015-17.

Consumer spending growth to stay at 7%pa

A fast-growing consumer market has attracted scores of foreign retail firms, such as Koreas' Lott, GS25 and E-Mart, Japan's 7-Eleven, and Thailand's B's Mart. Household purchasing power is supported by a tight jobs market (2.2% unemployment in 1H'18, and 7.7% wage growth in 2017) and easier access to consumer credit, which surged 65% in 2017 from 50.2% in 2016. Meanwhile, the central bank is containing inflation risk.

Capex growth supported by surging FDI

Fixed investment grew 9.5%pa in 2014-16 before easing to 8.9% in 2017. That includes a surge in foreign direct investment (FDI, up 11%pa over the last five years), which has gone into new manufacturing capacity (65% of registered FDI inflows over 2013-17) and real estate (9% of registered FDI inflows for 2013-17). However, public works are facing delays due to budgetary constraints, which the government aims to ease with increased private sector participation in infrastructure projects. This could take time and result in overall capex growth slowing to 7.7% in 2019 from 8.0% In 2018.

More inflation & a slightly faster Dong slide on the US$

Inflation rose to 4.7%yoy in June from 2.7%yoy in January on the back of higher food and transport prices and we expect it to reach 5% in 2019 as the central bank is under pressure from the government to support local demand growth, by keeping its policy interest rate at the current 6.25%. As inflation lifts, we expect the Dong to come under growing downward pressure, with an average 1.5% fall on the US$ for the six years to 2017 lifting to 2.5% in 2019.

	2015	2016	2017	2018	2019
GDP, real growth, %	6.7	6.2	6.8	6.6	6.2
CPI, yoy, % (2014=100)	0.6	2.7	3.5	3.7	5.0
Central bank refinancing rate, year-end, %	6.50	6.50	6.25	6.25	6.50
Dong to US$1, year average	21,677	21,932	22,370	22,703	23,278

Source: 2015-2017 data from the IMF and CEIC; 2018-2019 forecasts by IMA Asia

India

Political & policy issues to watch

India's political winds have shifted

… as Congress revives a national coalition strategy to challenge the BJP

India's political outlook has shifted in 2018, as PM Modi's promise of reform-driven growth has spluttered and a disorganised opposition has become a bit more organised. PM Modi is still likely to win a second 5-year term in 2019, but his BJP party may find much of its 2014 landslide win reversed. Central to the changed outlook is the result of the Karnataka state election in May, where the BJP won most votes but lost government to a last-minute coalition cobbled together by the Congress Party and a regional party. That has inspired Congress and its often-wobbly leader Rajiv Gandhi to race ahead on building a state-by-state network of coalition partners who can beat the BJP in 2019 on local issues. That wouldn't have worked if the BJP had delivered on its promise of reform-driven growth. But for most voters the dominant events of the last two years are the painful and inexplicable demonetisation of November 2016 and a chaotic GST introduction from July 2017. Neither of these national policies help the BJP.

Watch for a swing in public spending to farmers and consumers

… as big reforms make slow progress

PM Modi is responding to the new political contest. Complex policy challenges, such as privatisation, are being jettisoned and the GST is being watered down, with the tax rate on some 50 major consumer goods slashed at the end of July. We expect Modi to build on a 2018 growth recovery with extra spending targeted at farmers and urban consumers. He'll still push forward on restructuring bad debt at state banks and a big infrastructure program, but progress in both areas has been slow and the impact on growth and job creation has been modest. Under Modi, road construction has risen to 22km/day; while that's double the pace of prior governments it is half the goal he set. A key challenge is that many of the main contractors have weak balance sheets and are unable to finance operations. The government is testing alternative public-led funding options that look promising and they may help boost road works over the next year.

Outlook for the market

A 1H'18 recovery is set to build in 2H'18

Once upon a time, India's growth was measured on a broad industrial production index covering mining, manufacturing, and electricity. It's still useful, and for the first five months of 2018 it was up 5.4%ytd from 3.5% growth in 2017. An array of other business and consumer indicators point to a recovery from the policy-induced slump of 2017. As argued in our Q2 Asia Forecast Book, near 8% growth is possible in 2018 and 2019, particularly if PM Modi delivers a shot to consumer demand ahead of the May 2019 polls.

Consumers lead the upturn

… strong sales of vehicles

… and basic FMCG

India's main driver is consumer demand, which was 75% of GDP in the 1980s, but has settled towards 55% today, as the economy has diversified. Vehicle sales are the best quick measure for consumer demand and they show a firm 2018 upturn. 2-wheeler sales jumped 21%yoy in 1H'18 (to June) from 9% growth in 2017, while passenger vehicle sales rose 11%yoy from 7% growth in 2017. That fed into commercial vehicle sales, which jumped 38%yoy in 1H'18 from 9% growth in 2017. 3-wheeler sales (reflecting small cash businesses) had the biggest rebound, up 73%yoy in 1H'18 from 6% growth in 2017. A 12%yoy lift in sales volume in the June quarter for Hindustan Lever confirms the recovery across village India. We expect real growth in consumer spending of 6.7-7.0%pa in 2018 and 2019 from 5.9% in 2017.

Capex growth has also lifted

Critically for PM Modi (and for India) real growth in capex needs to lift from last year's 5.4% pace. Q1'18 saw an acceleration to 14.4%yoy and we expect 8-10% growth this year and in 2019, as civil works pick up steam and housing demand stays strong.

The Rupee's 1H'18 slide should slow

Inflation (on the CPI measure) edged up to 5%yoy in June, which is within the RBI's 2-6% target range. But with the Rupee down 7.8% on the US$ since the start of 2018, the RBI lifted its policy rate by 25bp in June (to 6.25%) with a similar hike likely in August. That shouldn't undermine the recovery in local demand, and it will help limit the Rupee's fall.

Calendar year starting January	2015	2016	2017	2018	2019
GDP (MP, 2011-12), real growth, %	7.6	7.9	6.2	7.3	7.4
Inflation - CPI, %	4.9	5.0	3.3	5.1	5.0
RBI repo rate, December, %	6.75	6.25	6.00	6.50	6.50
Rupee to US$1, year average	64.1	67.2	65.1	67.1	68.5

Sources: 2015-2017 data from the government (NCI, RBI) and CEIC. 2018-2019 forecasts by IMA Asia with guidance from IMA India.

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Australia

Political & policy issues to watch

A by-election setback for PM Turnbull

… which puts corporate tax cuts in jeopardy

… and sets up Labor for a win in the 2019 polls

The failure of PM Malcolm Turnbull's government to win any of the five by-elections held during July leaves his Liberal-led Coalition government with a single seat majority in the lower house, while it remains dependent on negotiations with minor parties in the senate to pass legislation. The opposition Labor Party retained all four of its seats that were contested in July, with a swing of almost 10% in two Western Australian seats. That will help Labor leader Bill Shorten, who has been trailing behind PM Turnbull in opinion polls (a net satisfaction rating of -25% versus -6%). Meanwhile, the Coalition's ability to win support in the senate will decline as minor parties see voters rejecting government policies. The government managed to pass A$144bn worth of personal tax cuts (spread over seven years) in July with the help of minor parties in the senate. But, as the following by-elections in July showed, the promise to further legislation to cut the corporate tax rate to 25% from 30% means nothing to voters and may be a negative. With elections approaching in 2019, Turnbull may have to abandon the promised corporate tax rate cut. That may not be enough to save the Coalition, with a change in government likely next year.

Turnbull might gamble on a half senate election in late 2018

To escape defeat in 2019, PM Turnbull might resort to calling an election for half the senate in late 2018 by itself instead of alongside a lower house election, as has been done by convention over the last 50 years. Technically, the next half senate election must be held between August 4, 2018 and May 18, 2019, while the next lower house poll need not be held until November 2, 2019. It's a gamble, but it might clear the path for passing legislation in the senate and put the government in a better position for a late 2019 lower house poll.

Outlook for the market

Growth to slow in 2019 as the housing market cools

Big swings in growth between the commodity-exporting states of WA, NT and Queensland and the population-heavy states of NSW and Victoria have kept Australia on an uninterrupted growth path over the last 26 years (a record in the OECD). The constant rebalancing has been helped by a flexible exchange rate, an astute central bank, and a large skills-based inward migration program that lifted population growth to 1.6%pa. The recent housing boom, which helped offset a slump in mining capex from 2012, is now retreating. In its place commodity export volumes and prices are both rising. The mild swing back to Australia's commodity growth engine should sustain GDP growth of 2.8% in 2018 and 2.6% in 2019 from 2.3% in 2017.

High household debt + falling home prices will hurt consumer demand

Faced with stagnant wages and increasingly unaffordable housing, Australian households have lifted debt to record levels and dropped their savings ratio to 2.1% in Q1'18 from a recent peak of 10.4% in Q4'08. Recent spending was also supported by rising employment growth (3%yoy in 1H'18 from 2.3% in 2017 and 1.7% in 2016), which helped maintain consumption real growth at 2.6 %pa over 2014-17. However, an emerging downturn in the housing market presents a strong headwind for highly indebted households, while falling passenger car and SUV sales, along with slowing retail sales suggest that consumers are pulling back on spending. We expect consumption growth the ease to 2.4% in 2019 from 2.6% in 2018 and 2.7% last year.

Watch for a lift in public works

Fixed investment has staged a recovery from a deep four-year slump (-3.7%pa over 2014-16) with a 3.1% increase in 2017 and 3.5%yoy in Q1'18. The capex upturn reflects the end of a major downturn in mining investment and rising infrastructure spending by both the federal and state governments. A sustained lift in public works and a modest pickup in mining capex should partly offset the impact of falling residential construction and help deliver fixed investment growth of 2.4% in 2018 and 2.2% in 2019.

Interest rates on hold with the A$ range-bound

The RBA is under no pressure to change its policy interest rate, which has been at a record low of 1.50% since August 2016. Inflation remains low at 2.1%yoy in Q2'18 from 1.9%yoy in Q1'18. The A$ is likely to stay within the 0.73-0.80 range it established on the US$ since early 2017, as the impact of an unfavourable interest rate gap with the US is being partly offset by supportive commodity prices.

Year ending December 31	2015	2016	2017	2018	2019
GDP, real growth, %	2.5	2.6	2.2	2.8	2.6
CPI, year average, %	1.5	1.3	1.9	2.2	2.6
RBA cash rate, year-end, %	2.00	1.50	1.50	1.50	1.75
A$1 = US$, year average	1.33	1.35	1.30	1.32	1.32
US$1 = A$, year average	0.75	0.74	0.77	0.76	0.76

Source: 2015-2017 data from the ABS, RBA and CEIC; 2018-2019 forecasts by IMA Asia

New Zealand

Political & policy issues to watch

A big swing in policy under Labour

… with a focus on incomes, social issues, and the environment

New Zealand's consumer and business sentiment indices are heading down (see below) even though PM Jacinda Ardern's approval ratings has surged to just under 60% from around 40% at last September's election. Her Labour Party came to power with the help of the nationalist NZ First party and the Greens, promising to address income inequality, which had grown during a decade of fast growth under a Nationals-led government. Her government has swung policy from the promise of tax cuts and extra infrastructure spending by the Nationals to a focus on increased public housing, social welfare, environment protection, and higher pay (the minimum hourly wage rose to NZ$16.50 from NZ$15.75 in April with a goal of NZ$20 by 2021). Responding to concerns about skyrocketing home prices and unaffordable housing, the new government has also cut NZ's migrant intake, which was one of the country's main growth drivers in recent years.

More scope for monetary easing when growth slows

Ardern's government has also amended the central bank's goals. To the RBNZ's existing goal of low inflation has been added the objective of full employment. That doesn't mean much today, as inflation is low, and unemployment has fallen to 4.4% in Q1'18 from 5.2% in Q1'15. However, when growth weakens, it should prompt the RBNZ to ease monetary policy sooner.

Outlook for the market

GDP growth slows as local demand growth eases

Rapid migrant and tourist inflows, a housing construction boom, and strong consumer demand underpinned 3.3%pa real growth over 2013-17. However, these domestic growth drivers are losing steam, with no sign that exports can pick up the slack. Annual net migrant flows fell 10.1%yoy in Q2'18, following declines of 5.5%yoy in Q1'18 and 0.8%yoy in Q4'17. The growth of annual tourist arrivals also slowed to 4.5%yoy in Q2'18 from 9.2%yoy in Q1'18 and a recent 16.7%yoy peak in Q3'16. Similarly, residential building activity growth fell to 2.5%yoy in Q2'18 from a recent peak of 18.7%yoy in Q2'16. Meanwhile, export growth eased to 5.7%yoy in Q2'18 from 10.5%yoy in Q1'18 and 13.2% in full 2017 (US$ basis), while import growth held up at 11.1%yoy from 14.4%yoy and 11.8% respectively. With these trends likely to continue, we expect GDP growth to ease to 2.5% in 2019 from 2.8% in 2018 and 3% in 2017.

Fewer new migrants will slow consumer growth

Consumer real growth eased to 2.9%yoy in Q1'18 from 3.9%yoy in 2H'17 and 5.0%yoy in 1H'17, as fewer migrants means less demand for housing and consumer products. Passenger car sales were down 4%yoy in 1H'18 after an 8.8% rise in full 2017. Slowing employment growth (3.1%yoy in Q1'18 from a 6.1%yoy peak in Q3'16) contributed to a downshift in the Westpac consumer confidence index to 108.6 in Q2'18 from a 113.4 peak in Q2'17. We expect consumer growth to settle around 3.5%pa in 2018-19 from 4.4% in 2017 and 5.0% in 2016.

Capex faces a big drop in business confidence

Fixed investment growth edged up to 5.4%yoy in Q1'18 from 4.1%yoy in 2H'17 and 2.9%yoy in 1H'17, on the back of a 12.2%yoy lift in plant & equipment capex. A big post-election drop in business confidence to a 7-year low is likely to make this a brief rebound. A separate survey found that only 2% of companies are planning new investments in Q2, down from 17% in Q1'18. Combined with weaker residential construction, this should result in capex growth easing to 1.3% in 2019 from 2.3% in 2018 and 3.5% in 2017.

Continued record low interest rates point to a falling NZ$

The RBNZ's policy interest rate has been at a record low of 1.75% since Q4'16 and is unlikely to change over the next eighteen months. Weak inflationary pressures (the CPI eased to 1.3%yoy in 1H'18 from 1.9% in full 2017) and softening economic momentum will allow the central bank to continue its accommodating monetary stance to end 2019. This will put addition downward pressure on the NZ$, which is down to 0.68 on the US$ in July from 0.74 in April this year.

Calendar years	2015	2016	2017	2018	2019
GDP(Expenditure), real growth, %	4.2	4.1	3.0	2.7	2.5
GDP(Production), real growth, %	3.6	4.0	2.8	2.6	2.5
CPI, year average, %	0.3	0.6	1.9	1.5	2.3
Official cash rate, year end, %	2.50	1.75	1.75	1.75	1.75
NZ$1 = US$, year average	0.70	0.70	0.71	0.70	0.67
US$1 = NZ$, year average	1.43	1.43	1.41	1.43	1.50
NZ$1 = A$, year average	1.07	1.07	1.08	1.09	1.13

Source: 2015-2017 data from Statistics NZ and NZRB; 2018-2019 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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