



McKinsey & Company

ASEAN Insights: Regional trends

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1. Global trends

GLOBAL ECONOMY AND EQUITY MARKETS ENTER 2017 ON A STRONG NOTE DESPITE GEOPOLITICAL UNCERTAINTIES

The global economy entered 2017 on a strong footing, with economic conditions improving despite lingering geopolitical uncertainties. In tandem, equity markets were buoyant, with the S&P 500 reaching its all-time high in January.

Global PMIs were strongly in the expansion zone, increasing to 52.7 for manufacturing and remaining steady at 53.3 for services. In manufacturing, improvement was largely driven by the United States and western European countries, where PMI readings rose to 21-month and 68-month highs respectively.

Moreover, consumer confidence rose in the US, China and the eurozone, with US sentiment recording its highest level in the past 15 years.

The US labor market continued to demonstrate strong performance, with Federal Reserve chair Janet Yellen describing recent labor market gains as “solid.” The unemployment rate remained low at 4.7 percent, while total nonfarm payroll employment rose by 156,000.

Inflation generally rose in advanced economies, driven by a rise in commodity prices. In particular, this increase in commodity prices has recently pushed up producer prices. Commodity prices rose for most groups of commodities (including industrial metals, livestock, and agriculture) in January, with the exception of energy. Energy prices declined slightly but remained above US \$50 per barrel. Notably, producer price inflation in the eurozone turned positive after four years of deflation.

In terms of policy, the incoming Trump administration continues to emit policy signals of lower taxes, increased infrastructure spending, deregulation, and closer ties with the energy industry. After increasing in the post-election period, US bond yields has decreased slightly, amid questions around the incoming administration’s policy priorities. That said, uncertainty around trade policies has done little to dampen ebullient equity markets, as the S&P 500 reached its all-time high in January.

The global manufacturing PMI rose for the fourth straight month in December, from 52.1 to 52.7

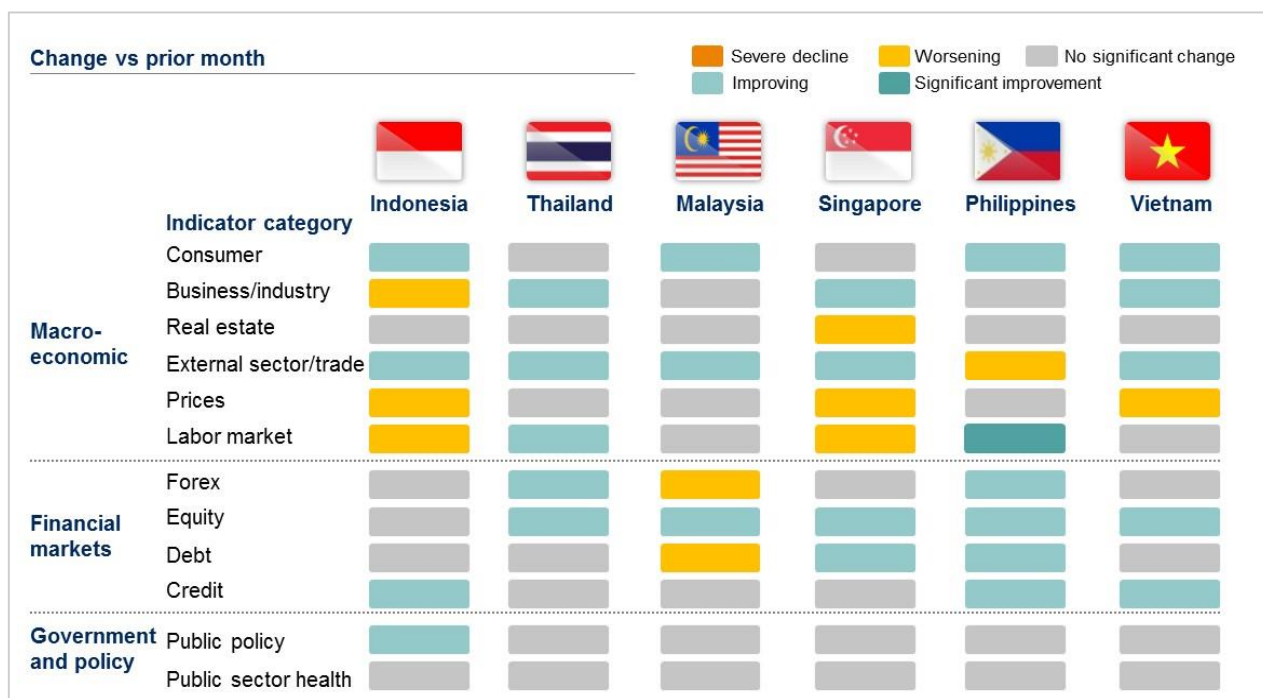


Note: A reading above 50.0 indicates expansionary conditions while a reading under 50.0 indicates contractionary conditions.

2. Regional trends: ASEAN

TRADE CONDITIONS IMPROVE; EQUITY MARKETS CONTINUE TO RALLY

Singapore registers better-than-expected GDP results but leading economic indicators for the region show mixed results



Trade volumes generally picked up in December, as Chinese imports continue to recover. Leading economic indicators were mixed, while inflation accelerated slightly across the region.

Macroeconomic trends

Trade volumes were largely higher this month, with Singapore's non-oil domestic exports rising by 9.4 percent year on year in December, after posting declines for most of 2016. Meanwhile, exports and imports grew strongly in Indonesia (15.6 percent and 5.8 percent respectively) this month, beating market expectations.

Consumer conditions remained mostly bullish in the region, with retail sales growing in all countries except Thailand. On a related note, inflation also rose across the region, with the exception of Indonesia (3.0 percent compared with 3.6 percent in the previous month). Inflation in Vietnam rose to its highest since July 2014 (4.7 percent), while Singapore's inflation was recorded at 0 percent in November, halting a deflationary trend for the first time in two years.

Business conditions were mixed, with the manufacturing PMI unchanged in Malaysia, rising

in Thailand and Singapore, but falling in Indonesia, the Philippines, and Vietnam. Notably, the PMI climbed to 50.6 for Thailand, led by an upturn in both output and new orders. This was the first expansion following seven consecutive months of contraction.

Financial markets

ASEAN financial markets continued to rally, with Thailand's benchmark SET index reaching a record high. The largest equity gains were recorded in the Philippines, with a month-on-month gain of around 5 percent.

The ten-year benchmark bond yield in Singapore fell back to 2.30 percent in mid-January, after spiking to 2.50 percent in December as a result of the hike in interest rates by the US Federal Reserve.

Government policy

Indonesia eased its ban on mineral exports, which has been in place since January 2014, to allow exports of nickel ore and bauxite under certain conditions.

3. ASEAN Insights: Country analysis

THE REGION AT A GLANCE



Indonesia

ECONOMIC PERFORMANCE WAS MIXED; TRADE VOLUMES AND RETAIL SALES PERFORMED WELL BUT INDUSTRIAL PRODUCTION CONTRACTED

Indonesia's economic performance was mixed.

Trade volumes grew in December, with exports and imports growing by 15.6 percent and 5.8 percent respectively. The export performance was attributable to strengthening commodity prices, and driven mainly by increased sales to most of the country's trading partners, including ASEAN (+4.2 percent growth), the European Union (+6.9 percent), China (+2.8 percent), and the United States (+8.9 percent).

Retail sales were strong, increasing by 10 percent year on year in November, following an 8.1 percent gain the previous month. In particular, sales rose at a faster pace for food, beverages, and tobacco (8.6 percent from 4.2 percent in October).

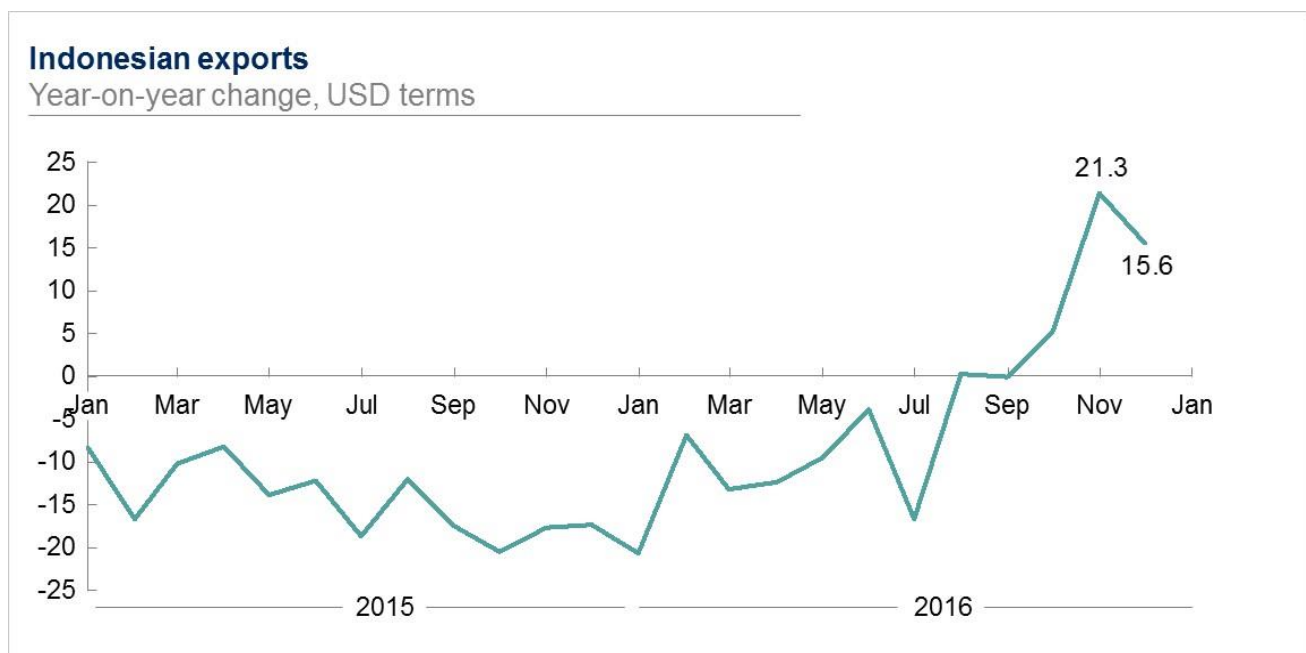
In contrast, industrial production contracted by 2.7 percent year on year in October. This contraction

may continue in the near future, with the manufacturing PMI falling to 49.0 in December from 49.7 in the previous month.

Inflation moderated to 3 percent in December, compared with 3.6 percent in November. Notably, prices rose at a slower pace for raw food (5.7 percent compared with 8.5 percent in November).

On the government policy front, Indonesia eased its ban on mineral exports in January 2017. Exports of nickel ore and bauxite will be allowed under certain conditions. This would likely boost Indonesian exports and have a net positive impact on the Indonesian economy, but the domestic nickel smelter industry – which had invested in building expensive processing facilities in the belief that it would have a guaranteed supply of ore – could be adversely affected.

Indonesian exports continued to grow strongly in December





Thailand

BUSINESS CONDITIONS IMPROVE; STOCK MARKET REACHES RECORD HIGH

Business conditions improved in Thailand, with some signs of a tentative recovery in domestic conditions.

Exports from Thailand rose by 10.2 percent year on year in November, after an unexpected decline of 4.2 percent year on year the previous month. This was the most rapid increase since February, as higher global oil prices lifted demand from the country. Imports rose by 3.0 percent, beating market expectations of a 1.0 percent decline.

Moreover, industrial production went up by 3.8 percent in November, supported by demand for automobiles, steel, and electronics. This was the fastest expansion since April 2013. Encouragingly, the manufacturing PMI rose to 50.6 in December, from 48.2 in November. This was the first expansion following seven consecutive months of

contraction, as a result of an upturn in both output and new orders.

Nevertheless, retail sales fell 1.2 percent in October, following a 3.2 percent rise in September. This was likely attributable to the passing of King Bhumibol in October, which prompted reported cutbacks in personal spending.

Price pressures rose in Thailand, with consumer prices increasing by 1.1 percent in December 2016, following a 0.6 percent upturn in November.

In terms of developments in financial markets, the benchmark SET Index reached a record high in January, as ASEAN equity markets continued to rally. Financial markets in Thailand have been mostly unaffected by recent floods in southern Thailand, which have caused global rubber prices to spike but are not expected to have a significant impact on the Thai economy.

Thailand's SET Index reaches a record high





Malaysia

MALAYSIAN ECONOMY SHOWS NASCENT SIGNS OF BOTTOMING OUT

The Malaysian economy showed tentative signs of bottoming out as trade volumes, industrial production, and retail sales all improved.

Trade volume rebounded significantly in November, with exports and imports rising 7.8 percent and 11.2 percent respectively year on year. In contrast, exports and imports fell 8.6 percent and 6.6 percent respectively in the preceding month. The rise in export was driven in particular by growth in sales of electronics (+13.2 percent), palm oil (+24.3 percent), and natural rubber (+27.6 percent).

Industrial production in Malaysia saw an uptick, increasing by 6.2 percent in November. This was the fastest growth in nearly two years, as output rose for all sectors: manufacturing (+6.5 percent), mining +4.7 percent), and electricity (+9.7 percent). Consumer conditions also improved. Retail sales in

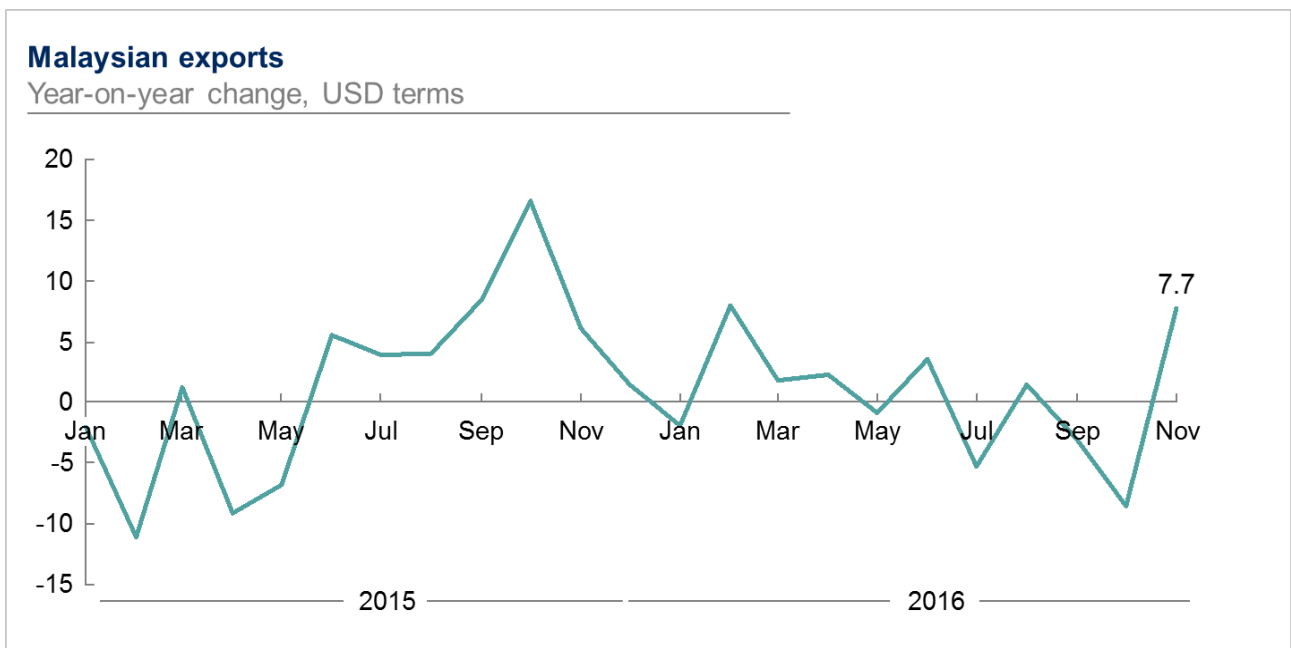
Malaysia increased by 9 percent in November, compared with a 8.7 percent rise in October.

Meanwhile, consumer price growth was stable at 1.8 percent in December, remaining at its highest level since May. A rise in inflation for food and non-alcoholic beverages was offset by lower price growth for transport costs, while inflation for housing and utilities remained flat.

Nonetheless, there were some economic indicators that were less positive. On the labor market front, the seasonally adjusted unemployment rate rose slightly to 3.6 percent in November, after recording 3.5 percent earlier.

In addition, the manufacturing PMI for Malaysia remained in contraction and stood at 47.1 in December, the lowest in the region. Nonetheless, this figure was unchanged from November, as the PMI showed some signs of steadying after falling over the past few months.

Malaysian exports rebounded strongly in November



SOME VARIATION IN ECONOMIC OUTCOMES, BUT CONDITIONS REMAIN POSITIVE

The Filipino economy saw a mixed performance in economic outcomes.

Consumer conditions maintained their positive momentum with retail sales growth rising to 3.6 percent year-on-year in November, up from 3.4 percent in October. Meanwhile, inflation accelerated slightly to 2.6 percent in December, following a 2.5 percent rise in November.

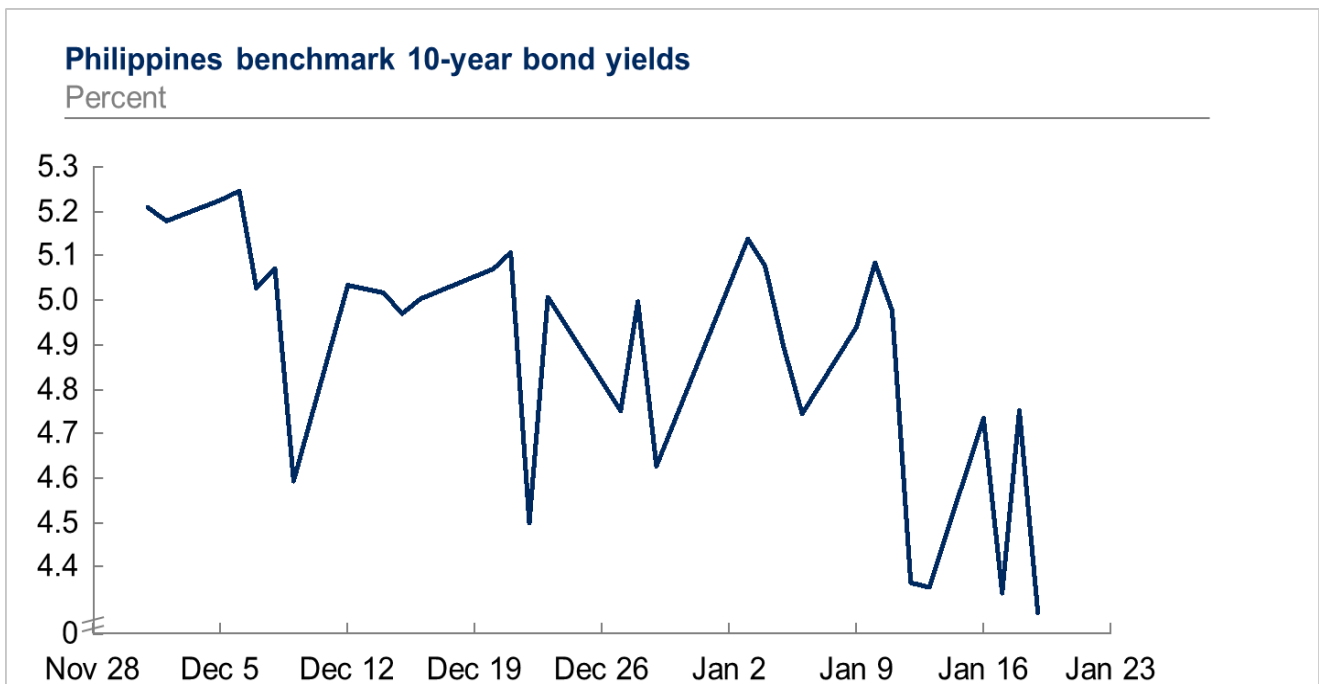
Business conditions were more varied. Manufacturing production jumped 10.6 percent in November, driven largely by higher output for petroleum and transport equipment. This was the strongest outturn for 2016 so far. In contrast, the manufacturing PMI fell to 55.7 in December, down from 56.3 in November.

On the external front, trade indicators were mixed. Exports fell by 7.5 percent in November, bucking the general trend of rising exports in the region.

Exports of electronic products (which account for the majority of Filipino export earnings) declined by 7.9 percent. This fall came about despite a strong upturn in the global electronics sector, as worldwide sales of semiconductors rose by 7.4 percent in November 2016. In sharp contrast, semiconductors exports from the Philippines in November 2016 fell by 9.7 percent in the same month. However, imports grew strongly, surging by 19.7 percent as orders of both consumer and capital goods rose by double digits. This reflects a strong underlying trend in consumer confidence and investment spending.

In financial market developments, benchmark ten-year bond yields have come down recently, after rising substantially in the wake of the US presidential results. In addition, equity markets in the Philippines performed well, growing by 6.6 percent month on month,¹ the strongest growth rate in the region.

Bond yields have come down recently since spiking in the wake of the US presidential election results



¹ Reference date: 19 December 2016–18 January 2017.

ECONOMIC GROWTH PICKS UP BUT CONDITIONS REMAIN CHALLENGING; SINGAPORE EXITS DEFLATIONARY TREND

Economic conditions in Singapore improved, with exports rising by 9.4 percent year on year in December, after posting declines for the majority of 2016. Advance estimates released by the government put Q4 GDP growth at 1.8 percent, much higher than market expectations of around 0.6 percent, and above the 1.2 percent figure in Q3. This brought overall 2016 growth to 1.8 percent, above the government's official forecast range of 1.0–1.5 percent.

On a quarter on quarter seasonally adjusted basis, GDP grew by 9.1 percent after a 1.9 percent contraction in Q3, dodging a technical recession (defined as two straight quarters of decline in economic output). The rebound was driven by a strong performance by the manufacturing sector, particularly the electronics and biomedical manufacturing clusters.

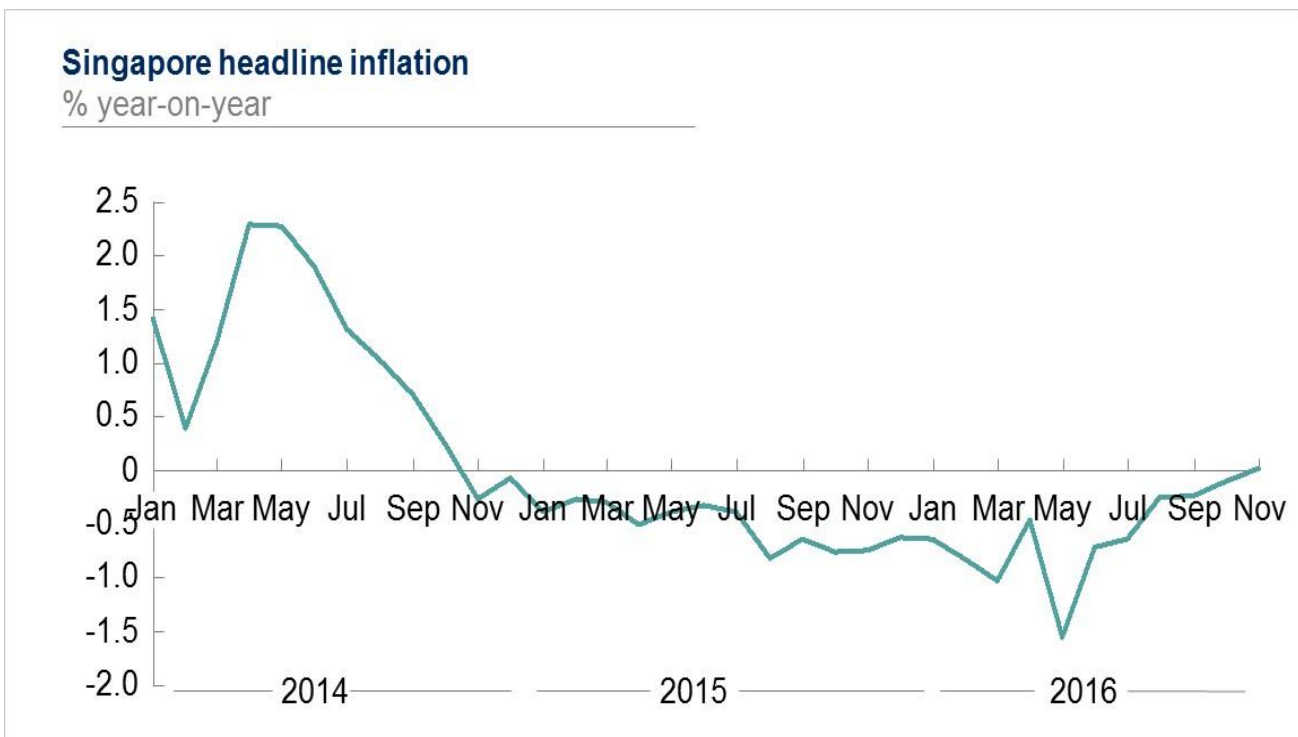
However, despite this strong performance, some caution is still warranted. First, advance estimates

in Singapore are based largely on data from the first two months in the quarter (October–November in this case), and can be subject to significant revision when more data becomes available. Moreover, the rebound was partly driven by the biomedical clusters, which tend to follow their own product cycles and can be volatile from month to month.

Second, trade-dependent Singapore is facing strong external headwinds, particularly with a possible change in the global environment and rising tide of protectionism.

On another note, retail sales in Singapore grew 1.1 percent year on year in November, slowing down from the 2.0 percent increase in October. Price pressures picked up slightly in November, with inflation reaching 0 percent, as an uptick in services and food inflation was offset by a fall in accommodation costs. This was the first non-negative outturn in two years, as Singapore finally exited its deflationary trend.

Singapore's inflation rate was non-negative for the first time in two years



BUSINESS CONDITIONS REMAIN EXPANSIONARY BUT PRICE PRESSURES BEGINNING TO SURFACE

The Vietnamese economy continued to grow robustly, with trade volumes increasing strongly. Export growth was particularly strong, rising by 21.2 percent year on year in December, while imports grew by 19.9 percent.

Industrial production growth also accelerated to 8.3 percent in December, up from 7.2 percent the previous month.

However, price pressures are beginning to surface. Inflation continued to climb, reaching a new two-year high of 4.7 percent in December. The inflationary environment may have had a slight impact on retail sales, which grew by 9.8 percent in December, down from 10.4 percent in November. In addition, the manufacturing PMI came down to 52.4 in December, below the 54.0 figure recorded the previous month.

Exports accelerated to grow 21.2 percent year on year in December—the fastest rate of growth since April 2014—while imports grew at 19.9 percent



Price pressures continue to climb with inflation recording a new two-year high

