Economic commentary

07/09/2018

Week Ahead Asia-Pacific Economic Preview

- **China's fixed asset investment, credit growth and industrial production**
- **Japan's GDP, industrial production and producer price inflation**
- **South Korea's jobless rate**
- **ECB and BoE set monetary policy**
- **Release of IHS Markit Sector PMI surveys (Global, Europe, Asia and US)**
- **Special focus on the ASEAN manufacturing hub**

With rising global trade frictions making markets nervous, analysts will eagerly await fresh economic data out of China for insights into the impact of new tariffs on Chinese economic activity. In Japan, updated GDP, industrial production and producer price inflation numbers will provide clues on growth and price developments.

Other highlights for Asia include jobless data for South Korea, inflation and industrial production numbers for India, as well as retail sales figures for Indonesia.

Elsewhere, the European Central Bank, the Bank of England and Russian central bank will meet to set monetary policy, while US economic data highlights include retail sales, inflation and wholesale inventories.

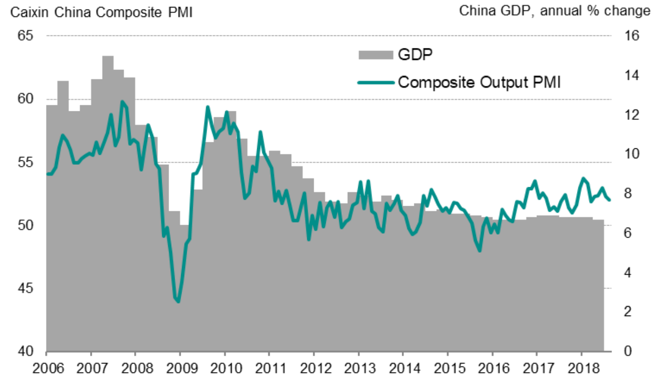
IHS Markit detailed sector PMI releases will meanwhile offer a view into the performance of various industries across the world, including detailed data for Asia.

Our special focus this week looks at the ASEAN region and its rise as a manufacturing hub.

China data updates

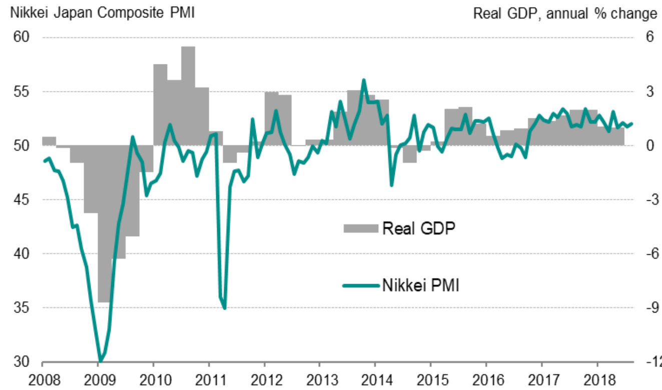
A busy week of data releases for China include fixed asset and foreign direct investment, retail sales, industrial production, inflation and credit growth. The official statistics come on the heels of the August PMI survey (covering manufacturing and services), which acts as an advance indicator of Chinese economic activity. The survey showed economic growth losing some momentum midway through the third quarter, with new business growth falling to the lowest in over two years. The survey also brought further signs that rising trade tensions had weighed on demand, particularly in the manufacturing sector.

China PMI and economic growth



Sources: IHS Markit, Caixin, NBS

Japan PMI and economic growth



Sources: IHS Markit, Nikkei, Japan Cabinet Office

South Korea employment

Source: KOSTAT

Continued…

Japan's GDP and producer prices

Of all the GDP numbers produced in the world. Japan's are possibly the most heavily criticised for revisions which re-tell history. It's a reasonable assumption, therefore, that the current estimate of second quarter growth of 0.5% will be revised. Nikkei PMI survey data suggest it will get tweaked slightly higher rather than lower, indicating a stronger rebound from an odd-looking contraction in the first quarter, which had not been reflected in the surveys.

Industrial production and manufacturing output numbers are also updated up to July, which will add colour to the health of the goods-producing sector in the third quarter. The official data follow survey evidence indicating robust output growth despite signs of sluggish exports.

Japan's data watchers will also keenly watch producer price inflation data (PPI) next week, which could offer clues on future consumer price trends. The PPI has moved higher in recent months, with PMI data suggesting that August figures could remain close to July's 3.1% annual rate which would, in turn, point to higher consumer price inflation in coming months.

South Korea jobs data

With South Korea seeing the weakest payroll growth in nearly nine years during July, analysts will be keenly monitoring fresh jobs data and in particular the jobless rate. Latest Nikkei PMI data signalled a broadly stable factory employment level following four months of decline, offering some hope that the official manufacturing jobs growth could improve.

Monday 10 September

IHS Markit Sector PMI for Global, US, Europe, Asia (Aug)

Japan GDP (final, Q2) and machine tool orders (Aug)

China inflation (Aug)

Turkey GDP (Q2)

Indonesia retail sales (Jul)

UK GDP, trade balance, construction output and industrial production (Jul)

Russia GDP (final, Q2)

Tuesday 11 September

Philippines trade (Jul)

Australia business confidence (Aug)

Euro area employment change (Q2)

UK employment change (Jun), jobless rate and average earnings (Jul) and claimant count change (Aug)

Euro area ZEW economic sentiment index (Sep)

Germany ZEW surveys (Sep)

Russia trade balance (Jul)

US JOLTs job openings and wholesale inventories (Jul)

Wednesday 12 September

South Korea unemployment rate (Aug)

Japan BSI large manufacturing (Q3)

Australia consumer confidence index (Sep)

China FDI (Aug)

India industrial production (Jul) and inflation (Aug)

Spain inflation (final, Aug)

Euro area and Italy industrial production (Jul)

US PPI (Aug)

OPEC monthly report

Thursday 13 September

Japan machinery orders (Jul) and PPI (Aug)

China total social financing and new yuan loans (Aug)

Australia jobless rate and employment change (Aug)

Malaysia retail sales (Jul)

India current account (Q2)

Germany and France inflation (final, Aug)

BoE monetary policy decision

ECB monetary policy decision

US inflation (Aug)

Friday 14 September

China fixed asset investment, industrial production and retail sales (Aug)

Malaysia unemployment rate (Jul)

Japan industrial production (final, Jul)

India WPI inflation and trade balance (Aug)

Italy inflation (final, Aug)

Euro area trade balance (Jul), labour cost index and wage growth (Q2)

Russia interest rate decision

US retail sales and industrial production (Aug)

US business inventories (Jul) and Michigan sentiment surveys (Sep)

Special Focus

ASEAN's rise as a global manufacturing hub

By Rajiv Biswas, Asia-Pacific Chief Economist, IHS Markit

Labour costs, industrial policies and geopolitical factors are all playing important roles in helping enhance the attractiveness of Southeast Asia as a global manufacturing hub. This article looks at the changing sources of investment into the ASEAN region and the manufacturing focus of each country, and explores why we forecast Southeast Asia to be one of the world's fastest growing regions over the next two decades.

Overview

The Association of Southeast Asian Nations (ASEAN) is seeing increased success in the APAC region as a leading global manufacturing hub, with inward investment flows having been reinforced by a number of factors since 2010. Among the key drivers for greater manufacturing investment in ASEAN countries has been rapidly rising manufacturing wages in coastal Chinese provinces. Rising manufacturing wage costs in China have made low-wage emerging markets in ASEAN such as Vietnam and Cambodia relatively more competitive for some segments of manufacturing such as low-cost textiles and electronics assembly.

The impact of industrial policies in some ASEAN countries, such as Malaysia's Economic Transformation Program for shifting towards higher value-added industry sectors and Vietnam's policies to attract technology industries, have also played a role in attracting manufacturing investment.

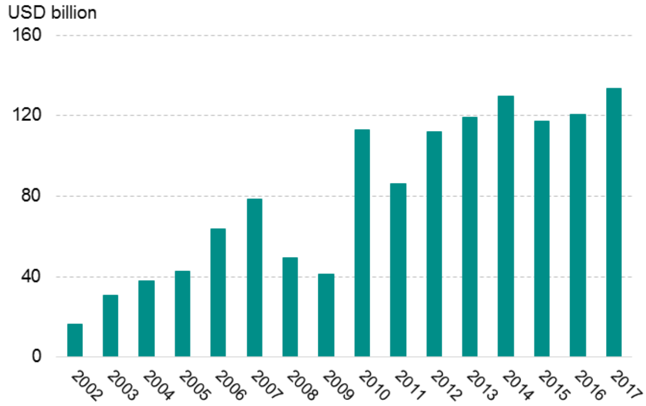
Over the past two decades, foreign direct investment (FDI) inflows to the ASEAN region have been trending upwards. Total FDI inflows to ASEAN were estimated at USD 133 billion in 2017 according to UNCTAD data. This was only slightly below total FDI inflows into China in 2017, which were around USD 136 billion, according to Chinese Ministry of Commerce statistics.

Geopolitical risks have also influenced multinationals to diversify their supply chains. The US-China trade war has heightened concerns about protracted bilateral trade frictions and the escalating impact of tariff measures on Chinese exports to the US. This is likely to increase the relative attractiveness of Southeast Asia as a manufacturing hub, as multinationals reposition their global manufacturing supply chains as a result of the changing trade policy landscape.

Sources of FDI Inflows to ASEAN

It's worth first looking at where inward investment is coming from. The largest source of FDI into ASEAN countries since 2000 has been the European Union (EU), which has accounted for around 22% of cumulative FDI inflows, with an estimated 9,000 EU firms now operating in the region.

FDI Inflows to ASEAN countries

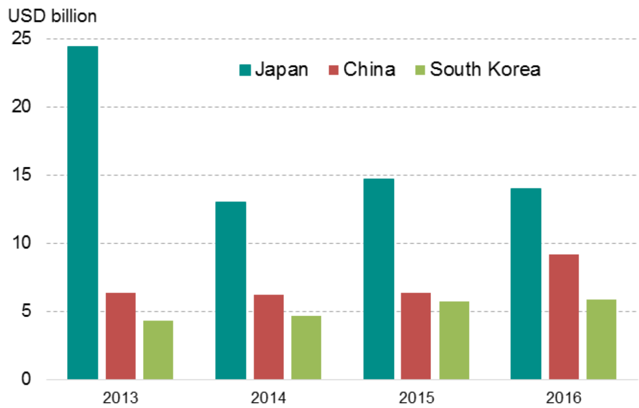


Source: UNCTAD

Intra-ASEAN FDI has also become increasingly significant, accounting for between 15% to 25% of total annual FDI inflows each year over the past decade. The US is also a large source of FDI into Southeast Asia, accounting for around 13% of total FDI inflows over the 2013-2016 period.

Other major sources of FDI inflows into ASEAN countries are Japan, China and South Korea.

North Asian FDI to ASEAN countries



Source: ASEAN

Japanese FDI has been one of the most important sources of foreign investment into Southeast Asia for decades. Japanese multinationals have had a strong manufacturing presence in many ASEAN countries since the 1960's, with substantial investment in Singapore, Malaysia, Indonesia and Thailand. However, since the early 1990's, increasing Japanese FDI flows went to China, attracted by very low Chinese manufacturing wages.

In 2012, widespread anti-Japanese protests in China heightened concerns among Japanese multinationals about their vulnerability to supply chain disruptions from their Chinese manufacturing facilities, and has helped to boost Japanese FDI flows to ASEAN nations in the past five years.

During the three years from 2015-2017, Japanese manufacturing FDI to Southeast Asia have exceeded Japanese manufacturing FDI into China each year.

Japanese manufacturing FDI to ASEAN countries accounted for around 50% of total Japanese manufacturing FDI to Asia during this period, highlighting the strategic importance of the ASEAN region as a key manufacturing hub for Japanese multinationals.

Two important new sources of FDI inflows into Southeast Asia over the past decade are China and South Korea. South Korean firms have become an important source of investment into Vietnam's electrical and electronics industry, with Samsung alone now accounting for 22.7% of total Vietnamese exports in 2017.

Southeast Asia's Fast-Growing Consumer Markets

While the export-competitiveness of ASEAN manufacturing hubs such as Thailand and Vietnam are an important factor attracting new manufacturing investment, the attractiveness of Southeast Asia for manufacturing FDI has also been boosted by the rapidly growing domestic consumer market.

The total population of ASEAN countries reached an estimated 640 million in 2017, with the size of the ASEAN region's GDP at USD 2.7 trillion. The size of ASEAN's GDP has grown very rapidly over the past decade, and is presently equivalent to just over half the GDP of Japan, the world's third largest economy. The ASEAN region's GDP size was also larger than Indian GDP in 2017. Sustained strong economic growth and the rapidly growing size of the middle class in populous ASEAN countries, notably Indonesia, Vietnam and the Philippines, are helping to drive buoyant growth in ASEAN consumer markets.

ASEAN's Manufacturing Hubs

Indonesia is the largest economy in ASEAN, with a total GDP that is estimated to have reached USD 1 trillion in 2018 and is forecast by IHS Markit to become a USD 2 trillion economy by 2025. Non-oil manufacturing output now constitutes a major sector of the Indonesian economy, accounting for around 18% of GDP. Japanese automakers in particular have made significant investments in the Indonesian automotive manufacturing industry in order to tap the fast-growing domestic market for autos and motorcycles.

Thailand, Malaysia, Singapore and the **Philippines** also have well-developed manufacturing sectors, with the electronics industry being an important industrial cluster in all four economies. In Malaysia, exports of electrical and electronic products account for around 35% of total Malaysian merchandise exports. In Singapore, around 27% of industrial output comes from the electronics sector.

Vietnam has emerged as one of ASEAN's most dynamic manufacturing hubs over the past decade, with the average annual growth rate in Vietnamese industrial production having been 10% between 2013 and 2017. A key factor that has driven the economic upturn in Vietnam since 2010 has been the rapid growth of electronics manufacturing, whose share of total GDP has risen from just over 5% in 2010 to around one-quarter by 2017.

Total FDI inflows into Vietnam's manufacturing sector averaged USD 8 billion per year during 2015-16. The strong growth in foreign direct investment flows into the Vietnamese manufacturing sector since 2010 has reflected a number of factors, including the competitiveness of Vietnam's relatively low manufacturing wages compared to rapidly rising wage costs in coastal Chinese provinces, a well-educated and skilled Vietnamese workforce, rapidly improving infrastructure and good port logistics for export shipments. The Vietnamese government has also implemented policy changes to encourage FDI in the electronics and IT sectors, as part of a trade strategy to improve the share of higher value-added manufacturing.

Cambodia has meanwhile become a hub for low cost textiles and garments manufacturing, mainly for export markets such as the US and EU. The sector has become an important source of employment growth for Cambodia's workforce, and directly employs an estimated 700,000 workers, as well as accounting for around three-quarters of Cambodian exports.

The economic liberalization of **Myanmar** since 2011 has also resulted in progress towards industrial development, notably via the establishment of the Thilawa Industrial Park, a joint public-private partnership project between Myanmar and Japan, with Sumitomo Corp, Mitsubishi Corp and Marubeni among the development consortium, which also included Mizuho, SMBC and BTMU. Myanmar's textiles and clothing export industry has grown rapidly, with exports reaching USD 2.2 billion in fiscal 2016-17, benefiting from the very low labour costs in Myanmar compared to China.

Outlook for ASEAN's Industrial Development

A number of key factors are driving the rise of ASEAN as a leading global manufacturing hub, with these trends expected to continue to boost the region's economic development over the next decade.

Firstly, rapidly rising manufacturing wage costs in China since 2010 have driven multinationals to seek alternative locations for low-cost manufacturing, with a number of ASEAN countries such as Vietnam and Cambodia being competitive hubs with relatively low manufacturing wages.

Secondly, geopolitical factors have accelerated this trend, as China-Japan political tensions that escalated in 2012 have resulted in many Japanese multinationals re-evaluating the vulnerability of their global supply chains to disruptions in production in China.

The escalating US-China trade war during 2018 has also created a further driver for multinationals to reposition their global supply chains and reduce their vulnerability to Chinese production. Rising US tariffs on Chinese products could significantly improve the relative competitiveness of ASEAN countries as manufacturing hubs compared with China.

Furthermore, the initiatives by some ASEAN countries to improve their industrial policies to attract more FDI have also helped to improve the business environment for foreign multinationals. The creation of the ASEAN Free Trade Area in 2010 in particular has created a favourable environment for manufacturing investment, by establishing a single market for free trade in goods within the ASEAN region, supported by a strong network of free trade agreements with other APAC countries, including China. Intra-ASEAN FDI flows have also become an important source of new direct investment into ASEAN countries.

As a result of these factors, Southeast Asia has become a fast-growing hub for global manufacturing investment, with total FDI inflows rivalling China. The rapid growth of FDI into the region is helping to accelerate long-term industrial development and boost the development of higher value-added industries. With the ASEAN group forecast to be one of the world's fastest growing regions over the next two decades, rapid industrialization is expected to continue to be an important driver of Southeast Asia's long-term economic development.

For further information:

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