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Editor: Richard Martin (richard.martin@imaasia.com)
Consulting economist: Kostas Panagiotou (kostas@imaasia.com)

Contents

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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www.imaasia.com

PT JASA CITA, Cyber 2 Tower, 6th Floor, Jl. HR. Rasuna Said Block X-5 No. 13. Jakarta 12950, INDONESIA
Tel: (62-21) 2902-1641 (Hunting), Fax: (62-21) 2902-1648, E-mail: castle@castleasia.com http://www.castleasia.com

Global outlook

A better 2016 as we've changed our view

… to a Euro area recovery

… steady US growth

… & resilience in Asia

We wrapped up our Q4 forecasting round with a slightly more positive outlook on 2016 due to two observations. The first is that growth is set to lift next year in both the Euro area and the US, which will support a mild export recovery for Asia. The Euro area's recovery will be supported by a broad-based cyclical upturn as consumers, businesses, and government end some six years of deleveraging. That upturn has been apparent through 2015 in the year-on-year measure for GDP growth, as well as a recent return to growth in bank lending to consumers and businesses. In the US, we expect an end to congressional gridlock on spending to allow government demand to support growth after a five year contraction (that contraction was the difference between 2% GDP growth and a more normal 3% recovery after a recession). This follows passage through congress of a two-year budget and debt deal as former Speaker John Boehner prepared to leave office. Our second observation, apparent in the following country pages, is that Asia's markets have once again proved more resilient this year than expected in the face of a global downturn.

Surviving the big risks

… a QE trap in the US

… capital flees from EM

… a collapse in China

… & an end to EM growth

As we live in unusual times, four big risks stand out. They'll make the next year volatile, but they shouldn't derail the upturn. The first risk is that the US fails to escape the "QE trap", so that even a slight lift in interest rates triggers a big drop in growth (as has happened to half a dozen countries attempting to exit QE). We think the US recovery is strong enough for a gradual lift in interest rates, as employment growth is strong and fiscal drag should stop. A second risk is that a lift in the US Fed's rate could trigger a rush for the exit from fragile emerging markets. It's hard to say how that will go, except that the Fed's move has been so well signalled that it's unlikely to trigger a sudden asset reallocation. A collapse in China is the third risk worrying markets, but we think that is unlikely (see the China page). Finally, some argue that the EM model is bust, and that poor countries no longer have a way to grow out of poverty by export manufacturing. While there are big changes underway in global manufacturing, there are more paths to growth than export manufacturing. In summary, a mild recovery in the Euro area, the US, and Asia should be sufficient to overcome the big global risks that can be picked at this point.

Watch for mild inflation to return

A return to mild inflation also lies ahead, as the plunge in commodity prices appears to have bottomed, and while significant price rises seem unlikely in the next year, flat prices are sufficient to allow headline inflation rates to lift towards the mildly positive rates for core inflation (CPI minus food and fuel prices). At October, core inflation was running at 1.9%yoy in the US, 1.1% in the UK, a two-year high of 1.1% for the Euro area, and 0.8%yoy in Japan. While that's supportive of a 2016 recovery, it won't mean the end of price falls in some manufacturing sectors that are struggling with excess capacity.

… and for more realignment of currencies

For many companies the biggest challenge over the last two years has been a realignment of the major global currencies, with the US$ and Yuan rising while the Yen and the Euro fell. That can mostly be explained by divergence in growth potential, risks, and QE programs. The realignment in exchange rates was particularly sharp in the last year (often 20%+ on currency pairs). Looking ahead, it's likely that the US$ will continue climbing on its trade weighted index as the Fed nudges up interest rates and US growth continues. Bigger QE programs are likely in the Euro area and Japan, so they are unlikely to regain ground on the US$ and may drop another 2-5% in 2016. China's Yuan has been mostly dragged higher by the US$, and is expected to slip 3-5% on the greenback in 2016.

IMA Asia's forecasts	2012	2013	2014	2015	2016
World – Real GDP growth, %	3.4	3.3	3.4	3.1	3.6
- US	2.3	2.2	2.4	2.1	2.6
- Euro area	-0.8	-0.3	0.9	1.5	1.6
- Asia/Pacific (14)	4.5	4.5	4.3	4.1	4.6
- NICs (4)	2.2	2.7	3.3	2.0	2.1
- Developing or "EM" Asia (7)	6.9	7.0	6.8	6.4	6.3
- ASEAN (6)	5.8	5.0	4.4	4.2	4.6
World goods & services trade volume, % growth	2.8	3.5	3.3	2.5	2.6
Interest rates, US Fed target rate, year end, %	0.10	0.10	0.10	0.25	0.50
Inflation, CPI, US, year avg., %	2.1	1.5	1.6	0.3	0.5
Inflation, CPI, Euro area, %	2.5	1.3	0.4	0.1	1.0
Crude oil, avg of 3 spot crudes, US$	105	105	103	50	55
US$ / Euro 1, year average rate	1.29	1.33	1.33	1.14	1.09
Yen / US$1, year average rate	80	98	106	121	126

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.

Richard Martin, IMA Asia ♦ Email: richard.martin@imaasia.com

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Regional outlook

Summary of forecasts in this month's Asia Brief

GDP (Expenditure), real growth, %	2012	2013	2014	2015	2016
Japan	1.7	1.6	-0.1	0.6	1.7
China	7.7	7.7	7.3	6.8	6.5
Hong Kong	1.7	3.1	2.5	2.3	2.5
Taiwan	2.1	2.2	3.8	1.3	1.7
South Korea	2.3	2.9	3.3	2.2	2.1
Indonesia	6.0	5.6	5.0	4.7	5.5
Malaysia	5.5	4.7	6.0	4.5	3.7
Philippines	6.7	7.1	6.1	5.7	6.0
Singapore	3.4	4.4	2.9	1.8	1.8
Thailand	7.3	2.8	0.9	2.5	3.5
Vietnam	5.2	5.4	6.0	6.2	6.4
India (CY)	4.9	6.4	7.1	6.7	6.5
Australia	3.6	2.1	2.7	2.3	1.9
New Zealand	2.9	2.5	3.0	2.7	2.4

Inflation, CPI year average, %	2012	2013	2014	2015	2016
Japan	0.0	0.3	2.8	0.6	0.2
China	2.6	2.6	2.0	1.4	1.3
Hong Kong (composite CPI)	4.1	4.4	4.4	2.9	1.4
Taiwan	1.9	0.8	1.2	-0.6	0.4
South Korea	2.2	1.3	1.3	0.5	0.3
Indonesia	4.0	6.4	6.4	6.7	5.1
Malaysia	1.6	2.1	3.2	2.2	2.1
Philippines	3.2	3.0	4.1	1.3	1.6
Singapore	4.6	2.4	1.0	-0.5	-0.2
Thailand	3.0	2.2	1.9	-0.8	1.0
Vietnam	9.1	6.6	4.1	0.6	1.1
India (CY CPI urban non-manual workers)	9.8	10.1	6.7	4.9	6.0
Australia	1.8	2.4	2.5	1.4	1.5
New Zealand	1.1	1.1	1.2	0.3	1.2

Exchange rate to US$1, year avg.	2012	2013	2014	2015	2016
Japan	80	98	106	121	126
China	6.31	6.20	6.14	6.26	6.56
Hong Kong	7.76	7.76	7.75	7.75	7.75
Taiwan	29.6	29.6	29.6	31.8	32.5
South Korea	1,125	1,095	1,052	1,140	1,199
Indonesia	9,384	10,460	11,868	13,383	13,788
Malaysia	3.09	3.15	3.27	3.90	4.45
Philippines	42.2	42.4	44.4	45.5	47.5
Singapore	1.25	1.25	1.27	1.38	1.44
Thailand	31.1	30.7	32.5	34.2	36.7
Vietnam	20,847	21,019	21,192	21,842	22,983
India (FY)	53.4	58.5	61.0	64.0	66.8
Australia	0.97	1.03	1.11	1.35	1.48
New Zealand	1.23	1.22	1.20	1.45	1.65

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

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Regional outlook

Political & policy issues to watch

Geopolitics works well for Asia in 2016

Asia enters 2016 with the prospect of reasonable political and geopolitical stability, and with most governments pursuing mildly reformist policies. That should keep sovereign ratings stable, and if they are changed by the debt rating agencies, upgrades are more likely than downgrades. This year saw the Asia Infrastructure Investment Bank (AIIB) launched by China, and the US-led Trans Pacific Partnership signed. It will take several years to see how they will work, but both should have a positive impact on regional growth. In particular, they should contribute to the type of cross-border linkages (infrastructure and trade) that are weak in Asia. Finally, Japan and China, the world's two largest pools of "patient capital", have started competing head-to-head for infrastructure and industrial projects in Southeast Asia. That too is a plus for growth.

Government changes to watch

… Taiwan, Vietnam, & the Philippines

Key leadership changes to watch in 2016 start with two in January. In Taiwan, the opposition DPP is set to win government from the KMT. While some fear that will disrupt commerce with China, we expect little negative impact. In Vietnam, 10 members of the Communist Party's 16-strong Politburo are due to retire, and that should see a pro-West and pro-reform faction gain a stronger position. In May, the Philippines will elect a new president, Congress, and thousands of local officials. The main concern is whether the next president will continue to support reform and an anti-corruption drive. We won't know until a year from now, but we think the economy is strong enough to prosper under a less helpful president.

Slow progress on reform in India & Indonesia

India and Indonesia were Asia's biggest disappointments in 2015, with pro-reform governments failing to deliver in the face of considerable political opposition. We expect better progress in 2016. A wipe-out in the Bihar state election has encouraged PM Modi to pursue reforms that are possible without relying on an obstructionist parliament. In Indonesia, President Joko Widodo is gradually gaining a stronger foothold in Jakarta, which should allow more reforms to pass in 2016.

Risk in Malaysia & Thailand

Political risk remains high in Thailand and Malaysia, having dragged growth in both countries in 2015. Risk is set to remain high in 2016, so care is needed even though there are modest growth opportunities in both markets.

Outlook for the market

Asia's 2016 outlook

… and end to our downgrades

After months of trimming our Asia Pacific forecasts, we've made little change this month. The main variation is slightly stronger 2016 growth for the four newly industrialised countries (NICs – Korea, Taiwan, HK, and Singapore) as a result of a better global trade outlook. We now expect 2016 growth of 2.1% for this group from 1.8% forecast last month (see the table on the Global outlook page). Two sets of countries stand out in this month's assessment. The first are the clear winners – the Philippines, Vietnam, and India – all with 6% or better growth in 2016. The second group are characterised by unexpected resilience in the face of China's slowdown. That slowdown should have knocked over Korea, Hong Kong, Australia, and New Zealand, as all have a high exposure to China. Yet domestic factors in each country have cushioned their downturns.

Spotting the 2016 opportunities

The debate in our quarterly forecast updates with clients often comes down to picking the best opportunities in the coming year after considering likely growth, risks, and operating challenges. Three sets of opportunities can be considered. Big opportunities that are challenging will be found in China, India, and Indonesia. In China, a complete overhaul of strategy may be needed, while India and Indonesia require persistence in the face of bad operating environments. Easier, but still significant opportunities are likely to be found in the Philippines and Vietnam. Finally, opportunistic plays have potential in frontier markets like Laos, Cambodia, and Myanmar, or in selling services to big firms heading overseas from Japan, Korea, and China.

Coping with a weaker Yuan

China risk – one of the four big risks considered in the global outlook – has a currency element for Asia, particularly as the region's currencies tend to be sticky on a rising US$. An expected 3-5% Yuan devaluation in 2016 will threaten export manufacturers across the rest of east Asia. A few analysts are arguing it could derail an EM recovery in 2016, and also touch off a round of competitive devaluations by countries like Korea and Taiwan. At present we see no sign of that, and Beijing has repeated a commitment to avoid competitive devaluations in 2016.

Richard Martin, IMA Asia ♦ Email: richard.martin@imaasia.com

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Japan

Political & policy issues to watch

PM Abe is in a strong position

… but moving slowly on reform

PM Abe is in a strong position, with his LDP-led coalition in control of both houses of parliament and likely to retain its majority in next summer's upper house elections as the opposition is in disarray. Abe also has firm control over the factions in his own party, which is important, as most of the opposition to reform comes from within the LDP. It is possible that Abe could bring forward lower house elections, not required until December 2018, to coincide with the 2016 upper house poll. Despite promising deregulation Abe has not used his strong position to push through reforms that might lift Japan's long-term trend growth above the modest 0.5% estimated by the Bank of Japan (BOJ). Abe is due to step down as LDP head in September 2018, and that means stepping down as PM.

Some policy wins in Q4

… two nuclear restarts, the TPP, & the Japan Post IPO

Abe has had three recent policy wins that will have some impact. Two nuclear reactors have restarted, accounting for 2.7% of the total nuclear power generation in October. That is some distance from the 20-22% share envisaged in the latest power plan by 2030, and it's far from clear how many of the 43 other operable reactors will restart. Trade ministers also signed off on the 12-country Trans Pacific Partnership, and Japan's commitments may provide a path for deregulation in contentious areas like agriculture. Finally, the November 4 IPO for Japan Post and its banking and insurance divisions went well, raising Yen 1.4 trillion (US$12bn). Apart from helping fund reconstruction, it opens the way to a more competitive environment in logistics, banking, and insurance.

Outlook for the market

A slip back into recession in Q3

… blame the sales tax hike, weak exports, & a lack of reform

… a brief lift in growth in 2016 on better exports & local demand

On the government's measure of quarter-on-quarter annualised growth, Japan has slipped into its fourth technical recession in five years with a contraction of 0.8% in Q3'15, following a fall of 0.7% for Q2'15. Year-on-year GDP grew 1% in both quarters, as the economy edged out of a four-quarter fall that followed the April 2014 hike in the sales tax to 8% from 5%. Apart from the sales tax hike, two other factors lie behind weak growth. The first is that the fiscal and monetary stimulus behind Abenomics has not achieved its primary goal of encouraging firms to turn record profits and cash holdings (mostly generated by dividends from offshore operations) into higher wages and investment. At the same time, exports fell 9.6%ytd by October (US$ basis, and in line with falls in Korea and Taiwan). That contributed to a 1%ytd fall in industrial production by September. We've trimmed our estimate of GDP growth this year to 0.6% (previously 0.8%). We expect a swing back to low export growth in 2016 along with a lift in demand as households and firms pull forward purchases from 2017 to avoid an extra two percentage points in sales tax from April 2017. That should lift 2016 GDP by 1.7%, although growth will likely drop to 0.5% or less in 2017.

Zero growth consumer market

… with sales driven by tax hikes more than wage growth

Consumer demand grew 0.7%yoy in Q3'15 from 0.4%yoy in Q2 after four straight quarters of contraction. That leaves consumer demand some 2% lower for the year to Q3'15 than it was in 2013. Over the same period, passenger car sales fell 5.6%yoy, while retail sales edged up 1.3%yoy in current prices. As Japan's population started falling at about 0.2%pa in 2011, volume declines are likely to be the norm in many categories except for those driven by older consumers. There are hints that a tight labour market (unemployment of 3.1% in October) and PM Abe's plan to lift the minimum wage by 3%pa for the next few years will push up pay. We estimate consumer growth will spike to 1.4% in 2016, as consumers buy durables ahead of the 2017 sales tax hike, after a 0.6% fall this year.

Despite big QE, deflation could return

Core inflation has been steady around 0.8%yoy for the three months to October, as the Bank of Japan's QE program pushes against global deflation, little wage growth, and weak demand growth. That leaves the BOJ on track to continue or even expand on its QE program through 2016.

A stronger Yen in 2016

At least for the next year companies should watch out for Yen weakness on the US$, as Japanese and US monetary policies are heading in different directions. A mild Yen fall would be roughly in line with expected declines of the Euro and China's Yuan. Once the US$ surge eases, the Yen could recover ground. If a global crisis emerges in 2016, the Yen would, as usual, rise as a safe haven currency.

	2012	2013	2014	2015	2016
GDP, real growth (2005p), %	1.7	1.6	-0.1	0.6	1.7
CPI, year average, %	0.0	0.3	2.8	0.6	0.2
Overnight call rate, year end, %	0.08	0.07	0.07	0.01	0.01
Yen to US$1, year average	80	98	106	121	126

Sources: 2012-2014 data from the BOJ and government sources; 2015-2016 estimates by IMA Asia

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China

Political & policy issues to watch

A return to policy stability

… the 13th plan reaffirms goals & strategies

… the pain of rapid rebalancing continues

Stock market gyrations and a sudden 3% devaluation in August left companies wondering whether China's hallmark policy stability was fracturing under pressure from a steady slide in growth and rising financial risks. Fortunately, Q4'15 has seen a return to policy stability with the outlining of objectives for the 13th Five Year Plan (13FYP, 2016-2020) and an invitation from the IMF to include the Yuan in its SDR basket. Both events highlight that China remains a policy-driven market with long-term goals achieved by steady policy evolution. That doesn't mean there isn't turmoil and risk in the operating environment. Rebalancing the economy means that the manufacturing and construction sectors face years of painful restructuring. So too do state-owned enterprises (SOEs), provincial governments, the army, and even foreign MNCs. While there are rumbles of discontent from the army and retired leaders, there is little sign of significant opposition or alternative agendas. So, 2015 closes with President Xi firmly in control of the country and policy making, and set on consolidating his authority with a second five-year term from 2017.

Actually, you can have two kids

... fixing a big demographic error

The decision to move to a two-child policy could lift the number of births by 38% in 2016 (or by 5.4m from a pre-policy estimate of 14.3m) according to Clint Laurent of Global Demographics (an annual guest in our meetings). The higher birth rate should provide a lift to firms targeting the baby/young child market. It will also help China's social security system cope with rapid ageing (under the one-child scenario, the ratio of active to retired workers was set to fall from 6:1 in 2000 to 2:1 by 2050). Beijing also announced that its social security system would be extended to all adults. Alongside pollution, concern over social security always tops the list of worries in any consumer polling in China.

Outlook for the market

A slide in growth eases

… but there's no return to higher growth

… China stays on track to double market value

2015 closes with indicators suggesting that while a three-year slide in growth may have stopped, a return to higher growth at any future point is unlikely. The debate over how fast China is growing rages, with the Conference Board putting growth at 3.7% this year and next year, while others think it is close to the official 7%, and a handful argue it is well above 7% as fast-emerging parts of a new economy are poorly measured. There is, however, little doubt that stabilising growth is at the top of President Xi's 2016 agenda, while 13FYP reforms aim to sustain growth at 6.5% to 2020. Our forecast remains for growth to drop from a 9.9%cagr for the decade to 2014 to a 5.3%cagr for 2015-20. Slower growth on a bigger base will almost triple the current value of GDP from US$6tr in 2010 to US$17tr in 2020, while GDP/capita jumps from US$4,500 in 2010 to $12,000 by 2020.

Coping with a two-speed economy

… weak growth in manufacturing & construction

… better growth in services

The above outlook may sound like a dream to China managers facing 5-10% sales falls this year across large parts of manufacturing and construction and some consumer sectors (notably luxury goods). Yet companies in services and other consumer sectors report sales growth of 5-10% as economic rebalancing produces a two-speed economy. This is reflected in many measures, including a three-year low for the official manufacturing PMI of 49.6 in November (from 49.8 in October), while the non-manufacturing PMI rose to 53.6 (from 53.1 in October). China's measure for industrial production (a value added index) shows growth dropping to 5.6%yoy in October from 8.3% for 2014 and 9.3% for 2013. We expect full year growth of 5.7% in 2015 and below 5% next year.

A more cautious and value aware consumers

A lot depends on what Chinese consumers do in the next year. This year has been marked by big shifts in behaviour (offline to online) and in tastes and preferences (notably greater value awareness); both shifts have caught some firms by surprise and helped others. Overall, we think real growth in consumer spending eased to 6.8% this year from an estimated 7.4% last year with a dip to 6.5% expected next year.

Plenty of stimulus to help growth

… & a 3-5% fall for the Yuan

To keep consumers spending and to encourage investors, the central bank has cut its policy rates six times in the last year, government buying agents have pushed the stock market up, and the local bond market lifted into overdrive to fund local governments and corporates. A Yuan devaluation of 3-5% is widely expected in 2016, as most analysts see the currency as overvalued with little reason for it to be dragged up by the US$ in 2016.

	2012	2013	2014	2015	2016
GDP, real growth, %	7.7	7.7	7.3	6.8	6.5
CPI, year average, %	2.6	2.6	2.0	1.4	1.3
PBOC 1-year loan, at Dec., %	6.00	6.00	5.60	4.35	3.85
Yuan to US$1, year average	6.31	6.20	6.14	6.26	6.56

Sources: 2012-14 data from CEIC and government agencies; 2015-16 forecasts by IMA Asia

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Hong Kong

Political & policy issues to watch

Democrats gain in District Council, but establishment still holds sway

Support for democracy is alive and well in HK after a record 47% of eligible voters took part in the local District Council (DC) elections on October 22. Pan-Democrats gained 5 percentage points from their 2011 results, including nine new members from the Occupy movement. But pro-Beijing forces still control 70% of the DC, which puts them in a strong position for the Legislative Council poll next autumn.

Tech bureau goes on line

… but with limited authority

Nearly four years after being proposed by the Chief Executive, the Innovation and Technology Bureau was finally established earlier this month with Nicholas Yang, former tech industry exec and first director of Cyberport, HK's controversial IT centre, as Secretary. But the bureau will not have responsibility for telecoms, broadcasting, or creative industries despite local industry demands.

"Two systems" remains critical

The government's annual survey of foreign and mainland firms in HK again placed "free flow of information" (2nd) and "rule of law" (4th) among the top attractions for investors. This reinforces the importance of sustaining "two systems" in the SAR.

Outlook for the market

Steady growth into 2016

… due to good local demand & PRC firms

HK arrives at the close of 2015 in a stronger position than might be expected, given its high dependence on China, whether that be for flows of trade, capital, tourists, or services. In part it is because local demand has been resilient. By September, fixed investment in building and construction was up 4.3%ytd, while consumer demand was up a surprisingly strong 5.2%ytd. Finally, a fall in mainland tourist arrivals has been offset by a surge in mainland companies setting up offices and buying properties. As a result, we expect GDP growth of 2% or better this year and 2016, down from 3.8%pa in the last five years.

Tourism hit by a strong HK$

… but hotels are full

… and local consumers are spending

Mainland tourist arrivals surged from a monthly average of 1.9m in 2010 to some 4m a month through 1H'15 before a fall towards 3.5m in some recent months. Moreover, it appears they are buying less according to surveys. As a result, the value of retail sales fell 2.8%ytd by September, with a 15%ytd plunge in jewellery and watches and a 6%ytd fall in clothing and footwear. Given the HK$ peg to a rising US$, it's hard to see this business reviving in the next few years, so a big turnover is underway in retail space. Hotels aren't feeling that pain, as occupancy rates remain in a 80-90% band and room rates are high. Meanwhile, local consumers are likely steady buyers, supported by a firm labour market (unemployment of 3.5% and 6.7%yoy growth in median monthly earnings at Q3'15). Resident departures were up almost 5%yoy (on a 3-month moving average) in October, the fastest growth since mid-2010. We expect consumer growth of about 4.5% this year easing to 3% next year, which is down slightly from the 4.6%cagr for the decade to 2014.

Taking a hit

… cargo, with a shakeout looming

… & capital markets

HK's trade has taken a hit, with port cargo down 8.8%ytd by August and air cargo up just 0.3%ytd by September (both are loaded & discharged). Container shipping rates to Europe are at record lows and well below cost. We think a mild trade revival should help next year (see Global page), but an industry shakeout looms in 2016. HK's role as a financial hub for China was mixed in 2015, but should improve in 2016. HK was hurt by China's ham-fisted efforts to control capital markets, so equity raised on the HK stock exchanged surged over 200%ytd in the first seven months and then plunged 70%yoy in the three months to October. Yet, China's gyrations also made clear the value of HK's better managed markets, and that is an attraction for mainland firms setting up in HK.

Little inflation & the US$ peg stays

Headline CPI inflation had eased to 2.1%yoy by September and will likely slide towards 1% in 2016 given the HK$-peg to a rising US$. The policy interest rate aims to follow the US Fed rate with a positive gap of 50 basis points. A 25 basis points lift in the local policy rate this December will have little impact in HK. The peg to the US$ will most likely stay, even though it is making HK uncompetitive in some areas, like tourism.

	2012	2013	2014	2015	2016
GDP, real growth, %	1.7	3.1	2.5	2.3	2.5
Composite CPI (04/05), year average, %	4.1	4.4	4.4	2.9	1.4
Discount window base rate, % year end	0.50	0.50	0.50	0.75	1.00
HK$ to US$1, year average	7.76	7.76	7.75	7.75	7.75

Sources: 2012-2014 from Censtat, HKMA, and CEIC; 2015-2016 estimates by IMA Asia.

Dr Mark Michelson, Chairman, Asia CEO Forum (Hong Kong)
Tel: (852) 2530-1115 ♦ Fax: (852) 2530-1125 ♦ Email: mark.michelson@imaasia.com

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Taiwan

Political & policy issues to watch

January 2016 polls

… will bring a change in government

… with the DPP expected to win

Taiwan's opposition party, the DPP, looks set to win the January 2016 elections for the presidency and also the legislature. An early November opinion poll puts support for the DPP's Ms Tsai Ing-wen at 48% against 21% for the KMT's presidential candidate, Eric Chu. That poll followed a historic first-time meeting held in Singapore between the leaders of China (President Xi Jinping) and Taiwan (President Ma Ying-jeou of the KMT), which appears to have done little to win voters to the KMT side. Both the KMT and Beijing are warning that a win for Tsai and the pro-independence DPP would have bad consequences for Taiwan's relations with China, which is a concern, given the island's dependence on China both as a market and an export manufacturing location. However, we don't see that as a major risk, as Taiwan achieved a 4%cagr under a previous DPP president (Chen Shui-bian, 2000-08) and Ms Tsai has been cautious in her policy statements. A bigger risk may be that the KMT holds onto the legislature (it currently has a 7 seat majority in the 113-seat chamber), and aims to stall Ms Tsai's legislative program in her first four-year term. The DPP held the legislature during President Chen's two-term government.

Watch the impact of a new property tax

A new capital gains tax on housing starts in January and its potentially negative impact is worrying firms in the property sector. A property tax hike alongside a close election is a startlingly bad political strategy that adds to the KMT's woes. Property prices started falling in 2H'14 and that will be a drag on consumer sentiment in 2016.

Outlook for the market

Growth slumps in 2H'15 as trade dives

GDP growth has slowed sharply through mid-year, dropping from 3.8%yoy in Q1 to 0.5%yoy in Q2, followed by a fall of -1%yoy in Q3. Much of this reflects the end of the electronics export boom that started in 2014 and ended in 1H'15. That has halted manufacturing jobs growth, ended overtime work, and resulted in weaker consumer and investment spending. With little government fiscal support due to caps on public debt, Taiwan will have to wait for an export upturn to help revive demand growth. Our analysis at our Q4 Asia Forecast meetings suggests better US and EU demand should emerge in 2016, so we expect GDP growth to lift towards 2% next year from around 1% this year.

… waiting for a mild 2016 export-led upturn

October manufacturing exports fell across the board, with machinery down 15%yoy, chemicals down 11%yoy, and electronic products down 4%yoy. The slowdown saw manufacturing growth drop from 6.3% in 2014 to 3.3% in 1H'15. We think full year manufacturing growth in 2015 will be even weaker at about 1%, with a recovery to 2-3% in 2016, provided a mild lift in exports emerges. A key indicator will be investment in the next generation of electronic chips (7nm), which the industry expects will start in 2H'16.

Consumers pull back

… + hopes for a continued surge in China tourists

Weak exports and a mid-year stock market plunge have cut consumer confidence and spending, with 1H'15 real consumer growth of 3.2%yoy slowing abruptly to 0.9%yoy in Q3'15. Weak jobs growth, falling home prices, and little pay growth is likely to see real growth in consumer spending slip from an estimated 2.4% this year to less than 2% next year. Tourism operators hope that the recent surge in visitors from the mainland continues even with a government change. It is on track for 4.2m this year from under 1m in 2009.

Construction will contract

Construction has cooled from a 2.5% lift in 2013 to 1.7% in 2014 and a fall of -0.5%yoy in 1H'15. Given the downturn in residential property (annual residential approvals were down 20%yoy by Sep'15), we expect growth of 0-1% for full 2015 and a fall of 0 to -1% in 2016.

No inflation and a mildly weak NT$

With little inflation there is room for further monetary easing into 2016. The central bank will favour a weak NT$ through 2016 to help exporters, although any depreciation is likely to be limited and in line with falls for the Yuan, Yen, and Won.

	2012	2013	2014	2015	2016
GDP, real growth, %	2.1	2.2	3.8	1.3	1.7
CPI, year average, %	1.9	0.8	1.2	-0.6	0.4
Official discount rate, year-end, %	1.88	1.88	1.88	1.63	1.63
NT$ to US$1, year average	29.6	29.6	29.6	31.8	32.5

Sources: 2012-2014 government data and CEIC; 2015-2016 forecasts by IMA Asia.

The above forecast is by IMA Asia. Companies seeking local advice and forecasts should contact:

Michael Boyden, Managing Director, Taiwan Asia Strategy Consulting
Tel: (886 2) 8789 0978♦ Fax: (886 2) 8789 0877 ♦ Email: michael@economist.com.tw

South Korea

Political & policy issues to watch

President Park is well-positioned for her last 2 years

A surprising political recovery by President Park Geun-hye in 2H'15 has left her in a strong position to serve out the final two years of her single five-year term – a period when prior presidents have often become lame ducks. She's using that power to back her supporters within the ruling Saenuri party for key seats in next April's general election. They'll likely do well, forcing out her opponents in the ruling party and enhancing her power. She has turned her attention to the current legislature, which has stalled some of her key reform bills, including labour market reforms and approval of a free trade agreement (FTA) with China. An immediate focus will be passing the 2016 budget by December 2.

A mild fiscal stimulus for 2016

The 2016 budget will keep fiscal policy mildly supportive of growth. Earlier plans for a quick reduction in the budget deficit have been put aside in favour of a 3% lift in spending. While this is one of the lowest increases in years, it needs to be seen against a backdrop of very low inflation and weak growth in tax revenues. The budget deficit will rise to 2.3% of GDP next year from 2.1% forecast for this year.

Outlook for the market

Firm local demand helps cushion the export fall

… strong construction

Korea is doing a better job than neighbours Japan and Taiwan, in offsetting an export collapse with stronger domestic demand. GDP growth for the first three quarters came in at 2.4%ytd thanks to a 3.3%ytd lift in fixed investment, driven by a strong construction sector. That helped to offset flat exports on the GDP measure. Looking forward, the two key issues are likely to be how Korean households maintain spending, given a high debt load and little wage growth, and the extent of a possible export recovery. As outlined below, the outcome could be better than we had previously expected, so we've lifted our 2016 forecast to 2.1% (previously 1.7%), which is still well below the Finance Ministry's 3.3% forecast in the 2016 budget. The government expects 3.1% growth in 2015, but we think growth will be closer to 2% as the final quarter will likely have an export fall (in GDP) and a reversal of the big stock run-up reported for Q3'15.

A rebound in consumer spending from Q4'15

… helped by interest rate cuts

… and more women at work

The MERS health crisis, which claimed 37 lives this year and saw consumers shun public venues, knocked retail sales growth for the first eight months of 2015 down to 0.6%ytd after 1.7% growth in 2014. September saw a recovery to 4.1%yoy growth, hinting that consumer demand could rebound in the final quarter. The Bank of Korea's consumer sentiment index climbed to 105 for October, its highest point in a year, suggesting that consumers aren't put off by weaker exports or high household debt loads. On the latter challenge, two points are worth noting. Four cuts in the BOK's policy rate since mid-2014 to a record low of 1.50% will have lowered debt service costs for consumers (the one-day delinquency rate for bank lending to households fell to 0.4% in June, the lowest level since the series started in December 2002). Moreover, the last 18 months has been a surge in female employment growth. The lift in the female participation will help households service their debt while maintaining spending. Given these developments, we expect consumer growth to lift to 2% or better in 2016 from 1.8% for 2015 and 2014.

A mild export manufacturing upturn in 2016

Manufacturing growth on the industrial production measure fell 1%ytd in the first nine months and we expect a full year drop of about 1.2% that will likely swing back to 1% or better growth in 2016 on a mild export recovery. Exports fell 7.6%ytd by October and will likely be down by 7-8% for full 2015 before swinging to 2-4% growth next year.

Little inflation & a mostly steady Won

CPI inflation was running at 0.9%yoy in October, and given that the government's fiscal stimulus is relatively mild, there's room for 1-2 more cuts to the BOK's policy rate to help domestic demand. The Won looks neither overvalued or undervalued on a real effective exchange rate basis, and we expect it to stay within a 1,100-1,200 band on the US$.

	2012	2013	2014	2015	2016
GDP growth, %	2.3	2.9	3.3	2.2	2.1
CPI, year average, %	2.2	1.3	1.3	0.5	0.3
BOK Base rate, year-end, %	2.75	2.50	2.00	1.25	1.00
Won to US$1, year average	1,125	1,095	1,052	1,140	1,199

Sources: 2012-2014 government data (NSO, BOK) and CEIC; 2015-2016 forecasts by IMA Asia.

The above forecast is by IMA Asia. Companies seeking local advice and forecasts should contact:

Tony Michell, Managing Director, Korea Associates Business Consultancy Ltd
Tel: (82 2) 335 7854/2614 ♦ Fax: (82 2) 323 4262 ♦ Email: tonymichell@kabcltd.com

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Indonesia

Political & policy issues to watch

The prospect of better government in 2016

President Joko Widodo ("Jokowi") is steadily gaining ground in Jakarta's complex political world. His isolation within the elite, along with a lack of support in the legislature, hurt government operations in his first year. Even major opposition party Golkar may now be ready to back Jokowi in parliament. This breakthrough comes after intensive lobbying by two senior administration officials, VP Jusuf Kalla and security coordinating minister Luhut Panjaitan. If a deal can be struck, it would put top Golkar leaders in play for cabinet posts in a reshuffle that is widely expected before year-end.

Pushing ahead on subsidy cuts

… may hurt some consumers

Jokowi's stronger position was reaffirmed with the parliament's passage of the 2016 state budget. The budget continues the nation's shift away from a consumption-focused subsidy regime towards state-led, investment-driven growth and more targeted social safety net programs. This includes eliminating electricity subsidies for low and middle-income housing, probably the most sensitive subsidy issue after fuel (which Jokowi tackled in the 2015 budget), and providing subsidies only for the very poor. Like 2015, implementation of these unpopular policies will be a key test in 2016.

A corruption scandal to watch

It is too soon to tell if reports of an attempt to extort shares from US miner Freeport McMoRan in exchange for help in obtaining a contract extension will blow up into a scandal that damages Jokowi's government. Coordinating Security Minister Luhut and House Speaker Setya Novanto (Golkar) are reported to be involved, but it looks to be much more dangerous for Golkar than the government and Jokowi looks likely to emerge stronger.

Outlook for the market

Growth slips in 2015

… with a mild 2016 recovery led by capex

Indonesia's economy has slumped in the last year with GDP growth of 4.7%yoy in each of the first three quarters, down from an average rate of 5.7% for the decade to 2014. The economy has been hit by a fall in commodity prices and export earnings (exports fell 14%ytd by October in US$ terms), weak government spending (down 7%ytd by September), and a slide in consumer demand. Looking forward, we expect a lift back to a 5-6% range due to stronger fixed investment growth, as the government does a better job of implementing its capital spending program alongside a return to weak export growth, as the collapse in commodity prices bottoms.

Consumers pull back as 2015 closes

… don't expect a 2016 rebound

Real growth in consumer demand in the first three quarters stayed close to the 5.1% set in 2014. However, retail sales growth fell to 5.8%yoy for October from 7.2%yoy for Q3'15 and 18.7%yoy for 1H'15. By October passenger vehicle sales were down 18.3%ytd (after a 37% fall in 2014), while motorcycle sales were down 19.4%ytd (from 1.6% growth in 2014). Clothing also retreated (-4.3%ytd by October), while household appliance sales were up just 1.1%ytd. Ecommerce is taking off in Indonesia this year, and it's hard to tell how that affects reported retail sales (Euromonitor estimates 34% growth for ecommerce clothing and footwear sales in 2015). The outlook for 2016 is weak, as consumer sentiment fell sharply in September and October. We expect real growth in consumer spending to dip from 5.1% last year to 4.9% this year and 4.7% in 2016.

Capex gets a lift in 2016 from better government

Fixed investment has been stuck at a 4-5% pace since early 2014, with plant and equipment capex weak or contracting in every quarter since mid-2013 while building work slowed to 5-6% growth from 2014. Bad government policies and poor public spending were part of the problem but private investors, both foreign and local, also pulled back. We think Jokowi can lift fixed investment growth back to 7-8% next year from 4-5% in 2015.

Inflation ebbs

… & so does the Rupiah

Core inflation (CPI excluding food and energy) has been steady around 5%yoy from the start of 2015 with headline CPI dropping from 7% in January to 6.2% in October. Inflation and the central bank's policy rate should both head lower into 2016. A lower interest rate and less support from foreign investors suggest a weaker Rupiah in 2016.

	2012	2013	2014	2015	2016
GDP, real growth, %	6.0	5.6	5.0	4.7	5.5
CPI, year average, (2007=100), %	4.0	6.4	6.4	6.7	5.1
Central bank policy rate (O/N rate) at Dec %	5.75	7.50	7.75	7.50	6.75
Rupiah to US$1, year average	9,384	10,460	11,868	13,383	13,788

Sources: 2012-2014 government data (BPS, BI) and CEIC; 2015-2016 forecasts by IMA Asia

The above forecast is by IMA Asia. Companies seeking local advice and forecasts should contact:

James Castle, Chairman, CastleAsia
Tel: (62 21) 2902 1641 ♦ Fax: (62 21) 2902 1648 ♦ Email: castle@castleasia.com

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Malaysia

Political & policy issues to watch

PM Najib's fight to stay in office rolls into 2016

Business deals, public administration, and the economy have all suffered this year as PM Najib Razak battles to retain office in the face of the 1MDB corruption scandal. Najib has considerable control over UMNO, the ruling party, so those within UMNO who want to replace him face an uphill battle. That battle looks set to continue into 2016, which will keep distracting the government and also delay some business deals that are exposed to the uncertain fallout from 1MDB.

No room for fiscal stimulus in 2016

Meanwhile, Najib has limited space in the budget for FY2016 (starting January 1) to help local demand as the deficit is to be cut to 3.1% of GDP from 3.2% this year and 3.4% last year. That limits the lift in spending to 2.3% while revenues grow 3.2%. Within those confines, the end-October budget speech attempted to support spending by lower and middle-income households with M$5.9bn in cash handouts to 7.4m households and civil servant pay rises (M$1.1bn). The monthly minimum wage was also lifted to M$1,000 from M$900 in Peninsula Malaysia and a number of medicine and food items were exempted from the newly-introduced 6% goods & services tax (GST). If Najib wants to get a lift in sentiment to help demand in 2016 that will have to come from private sector investment in a string of big projects his government has touted over the last year. That is an opportunity for China to step forward, while other investors have been put off by political risk.

A hard hit oil & gas sector faces consolidation

State-owned oil & gas giant Petronas has slashed its 2016 dividend by 39% to M$16bn, after its revenue and net profit plunged 25%yoy and 91%yoy respectively in Q3'15. It has also called for faster consolidation of Malaysia's overcrowded oil & gas sector, which has 3,700 companies compared to Norway's 700.

Outlook for the market

Growth slowed through 2015

… and faces headwinds in 2016

GDP growth eased to 4.7%yoy in Q3'15 from 5.3%yoy in 1H'15, due to a pronounced slowdown of private consumption (4.1%yoy from 7.6%yoy). Its impact on GDP was partly offset by a 4.3%yoy increase in fixed investment from 0.5%yoy in Q2'15 and small positive contributions from net exports and inventories. Despite a Q3 recovery, capex and household spending both face headwinds (see below). We expect GDP to grow 4.5% in 2015 and have lowered our 2016 growth forecast to 3.7% from 4.0% previously.

Bad politics & low oil prices will hold back capex

Rising political tension has hurt investment activity, as there is a close relationship between Malaysian politics and businesses. We expect growth in fixed investment to slow to 3-4% this year from 4.8% this year. Growth will likely dip to 2-3% next year, as housing approvals fell 32% in the year to July, while petroleum-linked investment activity is set to slide on weak oil and gas revenues. Meanwhile, foreign direct investment (FDI) approvals fell 56% in the year to Q3'15 (US$ basis).

High debt loads limit consumer demand in 2016

A steep fall in sentiment and employment indices in a Q3'15 consumer survey reflects a growing financial squeeze on Malaysian households. A cooling housing market and record high household debt (SE Asia's highest at 88% of GDP) suggest that real consumption growth is set to slow to 4% in 2016 from an expected 5.6% in 2015 and 7.2%pa posted in the decade to 2014.

The M$ plunge overshoots

… a recovery is likely at some point

A falling M$ and the new GST lifted headline inflation to 3%yoy in Q3'15. Given weak local demand Malaysia's inflation should fall towards 2% in 2016, allowing Bank Negara to lower its policy interest rate next year. A 30%+ plunge in the M$ on the US$ over the last year is double that of the next worst performer in ASEAN and reflects a combination of rising political risk and a weak economy. Further weakness is likely as the US Fed lifts its rate, but once local politics stabilises the M$ should recover some of the recent fall.

	2012	2013	2014	2015	2016
GDP, real growth, %	5.5	4.7	6.0	4.5	3.7
CPI, year average (2010=100), %	1.6	2.1	3.2	2.2	2.1
Central bank overnight policy rate, Dec, %	3.00	3.00	3.25	3.25	2.50
Ringgit to US$1, year average	3.09	3.15	3.27	3.90	4.45

Sources: 2012-2014 government, Bank Negara, & CEIC; 2015-2016 forecasts by IMA Asia.

The above forecast is by IMA Asia. Companies seeking local advice and forecasts should contact:

Datuk Paddy Bowie, Managing Director, Paddy Schubert Sdn. Bhd.
Tel: (60 3) 2078 4031 ♦ Fax: (60 3) 2078 7034 ♦ Email: pshubet@po.jaring.my

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Philippines

Political & policy issues to watch

Senator Poe extends her lead in the May 2016 presidential race

The May 2016 election for a new president, half the senate, all lower house seats, and thousands of local officials, looms over the outlook. Polling puts independent senator Gloria Poe ahead in the presidential race at 39%, followed by VP Jejomar Binay (24%), and Interior Secretary Manuel Roxas (21%). President Aquino, who wraps up a single 6-year term, has endorsed Roxas as the candidate most likely to continue his reform agenda, but Poe's movie star parents give her a cachet that is hard to beat. The immediate impact on the economy will be a wave of pre-election spending in 1H'15 that should support consumer demand. The medium-term impact will likely be a pause in big projects until a new administration has settled in and made its priorities clear.

Aquino's final spending spree targets capex

… and public sector pay

An anti-corruption campaign and weak public sector implementation left President Aquino with a lot of unspent money in this year's budget. In FY2016 (stating January), he aims to award 60% of the US$7.6bn public works spending during Q1. Aquino also wants to lift the pay of state employees to about 84% of the market rate from 55%. Middle managers will do best, with the goal of attracting and retaining more competent staff and reducing corruption. Through executive orders, Aquino hopes to cut through legal obstacles that have stalled his public-private partnership (PPP) investment programs.

Moving away from coal by 2040

The authorities are working on a new energy plan, which aims to lift the share of natural gas and renewables to one third each at the expense of coal for electricity generation by 2040. Coal accounts for 42.5% and its share is likely to increase further in the next few years as more coal-fired power plants are currently under construction.

Outlook for the market

OFW & BPO inflows drive up local demand

… as well as local salaries and imports

Strong inflows from offshore Filipino workers (OFWs) and business process outsourcing (BPO) position the Philippines as one of Asia's fastest-growing markets in 2015 and in 2016. Both channels produce about US$25bn in hard currency and both largely flow through to households (directly for OFW and by wages for BPO). Moreover, as some 10% of the population is working offshore (about 10m workers) and BPO work drives up pay for local talent, the result is a tight market for skilled labour and faster pay growth. That underpinned a 8%yoy surge in local demand in Q3'15 from 6.4%yoy growth in 1H'15, with GDP growth edging up to 6%yoy in Q3 from 5.4%yoy in 1H'15. The weaker GDP result is due to strong imports, which cut the net export contribution to GDP. Our forecasts of 5.7% GDP growth in 2015 and 6.0% in 2016 are little changed from last month.

Capex growth to lead GDP in 2016

Fixed investment was up 9.3%yoy in Q3'15, roughly in line with the 9.5%yoy of 1H'15. Full year growth for fixed investment in 2015 and 2016 should stay in the 8-10% range. Growth should be led by public infrastructure spending (mostly on highways, railways and airports), with private participation via PPPs.

Cashed-up consumers attract foreign retailers

While foreign direct investment (FDI) hit a record US$6.2bn in 2014, the pace has cooled this year with US$3bn arriving in the first eight months. One of the areas attracting greatest attention is the consumer market, with a proliferation of new shopping malls supported by international retailers. They are cashing in on a rising middle class created by OFW and BPO inflows (passenger vehicle sales were up 28%ytd by October after 47.8% growth in 2014). Consumer demand should grow by 6-6.5% in 2015 and 2016.

A mild slide for the Peso

Despite strong local demand, core inflation has dropped from 3% in 2014 to 1.5%yoy in October. That should allow the central bank to keep its policy interest rate at the current 4% well into 2016. The Peso fell 4.4% in 2014 on the US$ and is likely to drop 2-4% in 2015 and 2016 on a rising US$, making it one of Asia's strongest currencies.

	2012	2013	2014	2015	2016
GDP growth, %	6.7	7.1	6.1	5.7	6.0
CPI, annual average, %	3.2	3.0	4.1	1.3	1.6
Central bank reverse rep. rate, year end	3.50	3.50	4.00	4.00	4.00
Peso to US$1, annual average	42.2	42.4	44.4	45.5	47.5

Sources: 2012-2014 BSP data and CEIC; 2015-2016 forecasts by IMA Asia.

The above forecast is by IMA Asia. Companies seeking local advice and forecasts should contact:

Peter Wallace, Managing Director, The Wallace Business Forum
Tel: (63 2) 810 9606 ♦ Fax 810 9610 ♦ Email: pwallace@wbf.ph

Singapore

Political & policy issues to watch

A turning point in Singapore's industrial strategy

… downsizing manufacturing

For two decades Singapore's growth strategy has been based on reclaiming land and large imports of foreign labour. The result was a proliferation of container terminals, industrial estates, petrochemical factories, the iconic Marina Bay Sands Hotel & Casino, a new financial district, and the ever-expanding Changi airport. However, physical expansion has reached its limits. Neighbouring states no longer allow Singapore to obtain sand (about 517m tonnes over the last 20 years according to a UN report) and voters made clear in the 2011 election that they didn't like being swamped by foreign labour. The two immediate outcomes are a halving in GDP growth for 2015-20 from the 6.5% average for the decade to 2013 and an industrial shakeout, as manufacturing and construction firms have to drive up productivity or move out, as access to cheap foreign labour and local land dries up.

A mild lift in fiscal stimulus in 2H'15

The government appears to have quietly shifted to an expansionary fiscal policy in the first six months of the current fiscal year, which started on April 1. While operating income grew 7%yoy (including a 3.5%yoy lift in tax revenue), operating expenditure rose 9.8%yoy and development spending rose of 13.9%yoy, which saw the net cash position fall 7.8%yoy. However, there's little sign that the government will unleash a large fiscal stimulus to counter slowing growth, as it did in 2009. Even though growth in employment has slowed, the resident unemployment rate remains steady around 3%, modest growth in household incomes continues, and there's no sign of stress in the household, corporate, or bank sectors.

Outlook for the market

Growth to stay subdued into 2016

GDP growth eased to 1.9%yoy in Q3'15 from 2.3%yoy in 1H'15, despite a 4.3%yoy rise in domestic demand on the back of faster private and public consumption (5.2%yoy and 12.5%yoy respectively). Fixed investment remained weak, with a 0.2%yoy lift in Q3 following a 0.9%yoy rise in 1H'15. A steep rise in imports (6%yoy in Q3 from -0.4%yoy in 1H'15) accounts for the gap between domestic spending and GDP growth. Strong inventory accumulation in Q3 was likely unintended, and shouldn't be repeated in Q4. Overall these trends should leave GDP growth at 1.8% GDP in full 2015. We expect similar growth in 2016, unless the government abandons its reluctance to reflate the economy or global growth surprises on the upside.

Consumers turn cautious

The 5.2%yoy lift in private consumption in Q3 was not reflected in non-car retail sales, which grew around 0.5%yoy by both value and volume in Q3'15. Consumer confidence surveys point to a drop in sentiment in recent months with only 31% of households in an ANZ-Roy Morgan poll feeling better off than a year ago. Falling home prices (-4%yoy in Q3'15) and a less buoyant jobs market (employment growth eased to 2.4%yoy in Q2'15 from 4.2%yoy in Q3'13) are likely to blame. We expect consumer growth to ease to 2.2% in 2016 from an estimated 3.9% rise in 2015.

Little scope for new buildings

… but steady growth for civil works

A large oversupply of residential, commercial, and office real estate is been reflected in steep declines in the value of private and public construction contracts awarded over the last two years. The property downturn has longer to run, even if the authorities remove the curbs on residential property sales introduced over the last two years to avoid a bubble. Capex activity will be confined in on-going public works projects, such as extensions of MRT lines, the Singapore sea port, and Changi airport. These should sustain modest investment growth of 2.4% in 2016, from an estimated 0.5% increase in 2015.

Watch for a weaker S$

With core inflation (CPI minus food and fuel) dropping to 0.3%yoy for October from 2% for 2014, the MAS, Singapore's central bank, has room to ease monetary policy. As a small city-state dependent on imports, that is done by lowering the value of the S$ on an undisclosed basket of currencies. We expect that to see the S$ drifting towards 1.46 on the US$ by end-2016 from 1.41 currently.

	2012	2013	2014	2015	2016
GDP, real growth, %	3.4	4.4	2.9	1.8	1.8
CPI, year average, %	4.6	2.4	1.0	-0.5	-0.2
3 month interbank interest rate, Dec, %	0.38	0.40	0.46	1.30	1.65
S$ to US$1, year average	1.25	1.25	1.27	1.38	1.44

Sources: 2012-2014 government data and CEIC; forecasts for 2015-2016 by IMA Asia

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Thailand

Political & policy issues to watch

A focus on infrastructure to lift growth in 2016

With a new constitution rejected and the election date pushed back from 2016 to 2017 or later, Thailand's military government has shifted its focus to reviving a weak economy. Having underspent its FY2015 budget (which ended in October), the government plans a 20% increase in public investment in FY2016. A centrepiece in the new budget is a major expansion in road and rail links to the fast-growing markets in Vietnam, Myanmar, Laos and Cambodia. Part of this will be financed by a Thailand Future Fund, which should be set up in December. An earlier infrastructure fund (the Vayupak Fund, 2003-13) handily exceeded its targeted return of 3% for unit holders. With strong interest from Japan and China, Thailand should have little trouble attracting funds for infrastructure, either directly or via the new fund.

… and a new US$19bn energy plan

In late October, the government announced a new energy plan, which projects some US$19bn in spending on energy projects over the next 3-5 years by the public and private sectors. About half of this will be spent on petroleum projects, including LNG pipelines and terminals. The plan also aims to lift the share of renewables in the energy mix to 20% by 2036 from 8% in 2014.

Macro risk is stable

Fitch affirmed its BBB+ credit rating for Thailand with a "Stable" outlook in early November. The credit agency noted economic resilience, strong banks, and sound public and external finances. These advantages helped offset the risks in a fast ageing population, a highly-leveraged private sector, and declining export competitiveness. The rating is backed by ample foreign reserves (39% of GDP) and relatively low public debt (30% of GPD).

Outlook for the market

A mild 2016 lift driven by capex

GDP growth has been close to 3%yoy through the first three quarters thanks to higher export volumes and falling import volumes, particularly in Q3'15. The fall in import volumes reflects a slip in domestic spending growth to 0.8%yoy in Q3'15 from 3.5%yoy in 1H'15, as private consumption remained soft (up 1.7%yoy in Q3'15 from 2%yoy in 1H'15), and fixed investment fell 1.2%yoy in Q3 after rising 6.5%yoy in 1H'15. Strong public investment activity should help lift GDP growth to 3.5% in 2016 from 2.5% in 2015, provided a rise in capital goods imports for major projects is offset by a mild export recovery.

Consumer growth will be held back by weak farm incomes

Farmers, who constitute the vast majority of Thai households, have been hit by historically low crop prices, severe drought, the collapse of the previous government's rice price support scheme, and excessive household debt. Real agricultural output fell 5.4%ytd by Q3'15 after growth of just 0.3%pa over 2013-14. Some US$1.3bn in subsidies for rice and rubber farmers have just been approved, but conditions will remain tough until the drought eases and world demand for Thai crops recovers. The rural downturn will limit consumer real growth to 2.3% in 2016 from an estimated 1.9% in 2015.

A surge in public capex in 2015

Fixed investment is expected to be the main engine of growth in the next few years, led by the government's infrastructure and energy programs. The trend was apparent by Q3'15 with a 25%ytd rebound in public investment while private capex fell 2.3%ytd. Private capex should return to mild growth next year, as firms gear up around the infrastructure program and a mild lift in exports. There are hints of private sector optimism in a strong rise in FDI applications and approvals in recent months. Overall fixed investment should grow by some 3% in 2015 and 4-5% in 2016, after a 2.6% decline in 2014.

Little inflation and a weaker Baht

Despite a fall in core CPI inflation to 1%yoy in October from 1.6% in 2014, the central bank has kept its policy rate steady since April 2015, and will likely hold back on any stimulus given the government's construction drive. At 35.8, the Baht is 20% down on the US$ from its early 2013 high, and likely to drift lower on a rising US$ into 2016.

	2012	2013	2014	2015	2016
GDP, real growth, %	7.3	2.8	0.9	2.5	3.5
CPI (2002 index), year average, %	3.0	2.2	1.9	-0.8	1.0
Central bank, policy rate, year end, %	2.75	2.25	2.00	1.50	1.25
Baht to US$1, year average	31.1	30.7	32.5	34.2	36.7

Source: 2012-2014 data from the IMF and CEIC; 2015-2016 forecasts by IMA Asia.

The above forecast is by IMA Asia. Companies seeking local advice and forecasts should contact:

Christopher Bruton, Consultant, Dataconsult Ltd
Tel: (66 2) 233 5606/7 ♦ Fax: (66 2) 236 8143 ♦ Email: chris@dataconsult.co.th

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Vietnam

Political & policy issues to watch

Vietnam looks to the West

… for friends and trade

An official visit by China's President Xi Jinping in early November did little to bridge the gap between the two communist neighbours, which is based on historical animosity and a recent territorial dispute in the South China Sea. Instead, Vietnam will continue to pursue ties with the West with the help of recently agreed trade deals with the EU and the US-led Trans-Pacific Partnership (TPP). The westward shift will likely be reflected in a relatively liberal faction in the Communist Party, led by PM Nguyen Tan Dung, prevailing in the 12th Party Congress next January. With 10 out the 16 Politburo members due for retirement, Dung's allies are likely to dominate the top policy-making body, while Dung is expected to move to the party general secretary post, currently held by Nguyen Phu Trong.

External trade deals could drive domestic reform

Most commentators expect Vietnam to do best from the 12-country TPP trade deal, mostly through lower import tariffs on its clothing & footwear exports for brands such as Nike, Adidas, H&M, Gap, Zara, and Armani (such exports earned US$31bn in 2014). Seafood exports should also benefit. In addition, its inefficient state-owned enterprises (SOEs) will be subjected to greater competition, which will help speed up their restructuring, while an end to foreign ownership caps in some industries should encourage industrial consolidation. Meanwhile, some progress has been made on bank reform over the last year, with a decline in official non-performing loans to 2.9% of total outstanding loans in September from 17.2% in 2012. Credit growth also recovered to 12%yoy in September from 2.7%yoy in March 2015, reflecting improved bank balance sheets.

Outlook for the market

Strong capex growth should keep GDP at 6%+

… even as export growth cools

After defying a slump in global trade over the last few years, Vietnam appears to be succumbing as 2015 closes. Export growth (US$ basis) eased to 2.4%yoy in October from 9.4%yoy in Q3'15 and 9.1%yoy in 1H'15. While some recovery is possible in the next few months, new export orders in the purchasing managers index (PMI) for manufacturing have fallen for five consecutive months, pushing the overall PMI down to 50.1 in October from a recent high of 54.8 in May. The slowdown in external demand is moving into the local economy with factory wage growth slowing to 2.8%yoy in Q2'15 from 11.9%yoy in Q2'13. Offsetting the export and consumer slowdown has been strong growth in fixed investment, which has likely exceeded last year's 9.3%, rise as imports of machinery and spare parts were up 26%ytd by October from 20% in full 2014, while cement production was up 13%ytd from 5.4% growth in 2014. That should help keep GDP growth above 6% in both 2015 and 2016.

The foreign firms are taking over

Vietnam remains very attractive for foreign direct investment (FDI), with some US$12bn in new projects pledged in the ten months to October (up 24.8%ytd). Realised FDI grew 16.3%ytd to US$12bn, with most of this in the manufacturing sector. This is leading to lop-sided growth, as the performance of FDI-firms surges, while local firms struggle and few linkages are developing between the two sectors. FDI-firms produce nearly 70% of non-oil exports in 2014, up from 24% in 2000. The last year has seen even greater FDI interest in a booming local consumer market.

A surge in car sales in 2015

Strong wage growth over the last few years and a recovery in the property market helped passenger vehicle sales soar 143%yoy in Q3'15 from 98%yoy growth in 1H'15. Low household debt and rising incomes should lift consumer growth by 6.5% in 2016 from an estimated 6.3% in 2015.

Low inflation and a weaker Dong

Core CPI inflation fell to 1.7%yoy in November from 2.5%yoy in January, giving the central bank room to cut its policy interest rate from a current 6.50%. Lower interest rates would help the Dong weaken after being one of Asia's strongest currencies over the last two years. On a rising US$, the Dong could slide by 5% in 2016 after a 3% fall in 2015 and 1% decline in 2014.

	2012	2013	2014	2015	2016
GDP, real growth, %	5.2	5.4	6.0	6.3	6.4
CPI, yoy, % (2005=100 from 2007)	9.1	6.6	4.1	0.6	1.1
Central bank refinancing rate, year end, %	9.00	7.00	6.50	6.50	6.00
Dong to US$1, year average	20,847	21,019	21,192	21,842	22,983

Source: 2012-2014 data from the IMF and CEIC; 2015-2016 forecasts by IMA Asia

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India

Political & policy issues to watch

Bihar is a political setback for PM Modi

… and for reform

A surprisingly big loss for PM Modi's BJP-led coalition in the Bihar state election (it won just 58 of 243 seats with 34% of the vote) marks a turning point onto a more challenging road for the government some 17 months into its first 5-year term. Modi dominated in the BJP campaign, yet voters were unimpressed by his promises of reform-driven growth, voting instead along caste lines and favouring local politicians. That suggests the BJP will do poorly in a string of state elections in 2016. While there was little chance of the BJP gaining control of India's upper house by winning state polls in its first term (upper house members are appointed by the states), such wins help sustain political momentum. The opposition Congress Party will be boosted by the BJP's defeat, and will step up its efforts to block Modi's reform legislation, including the GST, in India's upper house.

… yet FDI jumps

… on optimism & an easing in FDI caps

PM Modi is now focusing on reforms that can be done without parliament. November saw foreign direct investment (FDI) caps removed in some construction and property sectors, direct-to-home media, cable networks, plantation companies, air chartering, and credit information, while the cap in broadcast media was raised to 49%. A requirement for 30% local sourcing by foreign retailers like IKEA was eased to 5 years from the opening of the first store. That will help sustain FDI inflows, which rose 51% to US$33bn in FY2014/15.

A 23% jump in public sector pay in January

Mid-November saw the government's pay commission recommend a once-in-a-decade lift in salaries and pensions for some 10m current and former civil servants from January. The recommended 2016 increase of 23%, which the government will almost certainly accept, will flow through to state-level public servants.

Outlook for the market

A lop-sided upturn in 2015

… capped by drought

India's economy has embarked on a lop-sided recovery. Q3'15 saw industrial production grow 4.6%yoy, its strongest lift since slumping into a 0-2%yoy band in 2H'11. The key drivers are interest rate cuts, a revival in urban consumer demand, and a mild lift in capex. Yet rural consumers (two thirds of the population) are struggling with drought and a surge in food prices. Using India's new GDP series (2011/12 prices, which is widely believed to overstate growth by at least one percentage point), GDP growth is stuck in its current 6-7% band next year. Vehicle sales data captures the pattern. Passenger vehicle sales, mostly to urban Indians, grew 6.3%yoy in Q3'15 (from 5% for the year to June) and commercial vehicle sales lifted to 9.5%yoy (from 2.4% for the year to June). But two-wheeler sales, an indicator for rural demand, fell 1.3%yoy in Q3 (from 4.9% for the year to June).

Strong urban consumer growth

… but rural demand slips

Urban consumer demand has lifted this year, which is reflected in a 29%ytd surge by September for domestic air travel from 9.5% growth for full 2014. A big pay hike for civil servants from January will sustain urban demand through 1H'16. By contrast, rural consumers will struggle with drought and food price inflation through the winter. Overall, that's likely to see consumer growth drop to 5-6% in 2016 from 6-7% in 2015.

Capex lifts on plant & equipment

… but not yet for construction

Capital goods production led the lift in Q3'15 industrial production with a 14%yoy jump, which suggests that a recovery in spending on plant and equipment has started. However, that hasn't reached construction, as cement production grew just 0.7%ytd by September from 6.2% for full 2014 and 4.6% for 2013. Overall, we expect fixed investment growth to lift to 5% this year from 3.1% in 2014, with 6-7% likely in 2016.

Dal prices soar

… ending rate cuts for now

Inflation is heading up after a 42%yoy jump in October for pulses (mostly peas and lentils for dal, a staple of the Indian diet) due to drought. This could lift inflation to 6-8%yoy through winter, and halt the RBI's recent easing cycle. The Rupee is expected to ease on a rising US$ over the next six months, with some support from capital inflows and strong foreign exchange reserves (US$350bn at September, close to record levels).

Calendar year starting January	2012	2013	2014	2015	2016
GDP (MP, 2011-12), real growth, %	4.9	6.4	7.1	6.7	6.5
Inflation - CPI, %	9.8	10.1	6.7	4.9	6.0
RBI repo rate, December, %	8.00	7.75	8.00	6.50	6.50
Rupee to US$1, year average	53.4	58.5	61.0	64.0	66.8

Sources: 2012-2014 data from the government (NCI, RBI) and CEIC. 2015-2016 forecasts by IMA Asia with guidance from IMA India.

The above forecast is by IMA Asia. Companies seeking local advice and forecasts should contact:

Adit Jain, Chairman, IMA India
Tel: (91 124) 459 1200 ♦ Fax: (91 124) 459 1250 ♦ Email: aditjain@ima-india.com

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Australia

Political & policy issues to watch

PM Turnbull lifts support for the government

.. but still faces a tricky senate

Two months after taking control of the government via a Liberal Party leadership spill, PM Turnbull has boosted the Liberal-National Coalition's hold on government. Mid-November polling puts support for the Coalition at 56%, while the opposition Labour Party trails at 44% on a two-party preferred basis. The next federal election is not required until November 2016, although governments generally pick an earlier date. While the Coalition would easily win the lower house, it's unlikely to gain a majority in the half-senate election. Turnbull will have to continue negotiating with minority party senators to get bills approved.

The GST could rise to 15% by 2018

A debate is underway on lifting the goods and services tax (GST) to 15% from its current 10% rate. While this is not government policy yet, it could well become policy before the next election. That would allow an endorsement by voters to assist the bills through the senate with the new rate taking effect within a year. There would be a short-term impact on the purchase of durables and on inflation, but no significant change to trend growth. Funds from the increased rate would flow through the states into healthcare and infrastructure. The GST rise would help Australia retain its AAA credit rating.

Nationalist sentiment blocks some FDI deals

The Foreign Investment Review Board (FIRB) has just rejected a takeover of Australia's largest cattle station by a Chinese firm. Chinese firms have become notable buyers of Australian assets, alongside Japanese firms (over the last 40 years) and UK and US firms. Nationalist sentiment is an important part of every major political party, so sensitivity to big foreign purchases won't go away. Strong public affairs work and careful structuring of deals should enable most foreign purchases to proceed.

Outlook for the market

Riding out the China slowdown

… thanks to lower rates, east coast demand, & a weaker A$

Australia would rate second to HK in dependence on the China market, yet like HK its overall growth rate has not collapsed with China's slide in growth. Nevertheless, China's downturn has had a big impact, with goods exports down 22%ytd by September (US$ value) and total fixed investment likely to be down some 6% this year from its 2012 peak, as a surge in mining capex over the prior 6-8 years retreats. Real GDP growth is likely to be sustained around 2% in 2015 and 2016 due to interest rate cuts, a revival in the big population east coast states, and a plunge in the A$, which has curbed import demand and boosted export earnings in areas like tourism and education. Australia is still a two-speed economy, it's just that the mining states (WA, Qld, NT and SA) are now contracting at 1-2%yoy after hitting 10% real growth in 2012, while the non-mining states (NSW, Vic, ACT and Tas) have seen trend growth lift towards 4% from 2% in 2012.

Plus property & construction surge on the east coast

The Reserve Bank of Australia (RBA) has cut its policy rate eight times in the current easing cycle, taking it from 4.75% in October 2011 to 2% from May 2015. That led to a 29% lift in capital city residential property prices from Q4'11 to Q2'15. The annual rate for housing approvals also rose by some 50% to 230,000 by September this year from 2011. The lift in building capex has cushioned the slide in mining capex and limited the rise in unemployment to around 6% (5.9%sa for October) from a recent low of 5% in late 2010. While the mining retreat means that total fixed investment will fall 1-2%pa in real terms over 2015-2017, capex on housing will likely rise some 10% this year and 5% next year.

Watch for a slip in consumer demand

Demand from east-coast consumers has eased this year but remains relatively good, with retail sales for NSW and Victoria up 5.4%ytd and 4.7%ytd respectively by September, while the national average rose 4.3% due to weaker growth in mining states like WA and Queensland. Pay growth has slowed, with average weekly earnings up 2%yoy at June (the smallest rise since the series started in 1994). That will see real consumer growth drop from 2.5% this year to 1.7% in 2016, below the 2.8%cagr for the decade to 2014.

… and a slightly weaker A$

With little inflation ahead, the RBA can keep its record low 2% policy rate through 2016. As the interest rate differential with the US Fed's rate narrows, the A$ should weaken. It also has downside risk as a proxy forex play on China, if China runs into trouble.

Year ending December 31	**2012**	**2013**	**2014**	**2015**	**2016**
GDP, real growth, %	3.6	2.1	2.7	2.3	1.9
CPI, year average, %	1.8	2.4	2.5	1.4	1.5
RBA cash rate, year end, %	3.00	2.50	2.50	2.00	2.00
A$1 = US$, year average	0.97	1.03	1.11	1.35	1.48
US$1 = A$, year average	1.04	0.97	0.90	0.74	0.68

Source: 2012-2014 data from the ABS; 2015-2016 forecasts by IMA Asia

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New Zealand

Political & policy issues to watch

PM Key aims for a 4th term in 2017

PM John Key aims to win a fourth term in the 2017 elections and on present trends that looks likely. Sound fiscal management, including privatisations in the energy sector, and steady reform have helped the economy shrug of a collapse in dairy prices due to weak China demand. The Labour and Green opposition parties are still sorting out internal divisions and have yet to reconfirm their usual governing alliance, without which they don't have the numbers to win government.

A surprise budget surplus

… leaves room for tax cuts in 2017

Strong growth in 2015 saw the budget return to an operating surplus of NZ$414m for the FY ending June 30, as opposed to a deficit of $684m forecast as recently as May by the Treasury. Tax revenues from both businesses and workers continued to be above forecast in the September quarter of the new FY. That puts Finance Minister Bill English in a good position to deliver tax cuts in 2017 before the election. The GST will be applied to all non-resident online service retailers (notably music, movies, and subscriptions) from October 2016, which is nine months ahead of a similar change due in Australia. Firms in this sector who handle ANZ as a single market will have to consider this.

Key risks

… a housing bubble

… and weak dairy exports

The main risks lie in a hot housing market, particularly in the main city of Auckland, and debt defaults by dairy farmers following a fall in dairy prices. Successful management of both risks is critical to the medium-term view on consumer demand and the housing market. Auckland's median house price of NZ$748,250 in September was up 17%yoy, which puts the house-price-to-income ratio among the highest in the world. From November 1, home loans in Auckland have required a 30% deposit, which should slow the price rise and push some demand to nearby regions. Following a 25% fall in dairy exports for the year to September (in NZ$ terms), some dairy farmers will be struggling with debts, although local banks, with strong balance sheets, will take a medium-term view of viability.

Outlook for the market

A mild slowdown in 2016 and 2017

… as local demand eases

Like Australia, NZ is riding out the slump in China, its dominant export market, thanks to strong local demand and a much weaker currency. Local demand is being sustained by strong population growth (driven by a net migration inflow) and a booming housing market. As both are likely to cool over the next year, we expect GDP growth on the expenditure measure to ease from 2.7% this year to (unchanged from last month) to 2.4% in 2016 (up from 2.2% last month). A similar easing will occur on the GDP production measure.

2015 closes with a lift in consumer demand

… watch for a mild easing in 2016

Consumers are in an upbeat mood as the year closes, with the ANZ-Roy Morgan consumer confidence index reaching a six-month high in November or 122.7 points (above 100 indicates optimism). Low interest rates and the wealth effect of rising house prices appear to have offset the impact of a collapse in dairy export earnings. Electronic card retail sales (some two thirds of all retail sales) were up 5.6%yoy in October, in line with the near 6%yoy growth in volume reported for total retail sales in Q3'15. Q3 sales growth by volume was led by electronic and electrical goods (6.6%yoy) and vehicles and parts (5%yoy), with F&B up 2.4%yoy. We expect real growth for consumer demand to ease from 3.3% in 2014 to 3% this year and about 2% next year (the decade cagr to 2014 was 2.5%).

A surge in building led by Auckland

September saw building consents rise by 17%yoy for residential work and 28%yoy for non-residential work. Trend growth for housing approvals is now at its highest level since November 2004, with approvals for Auckland surging well ahead of all other regions since 2012 and now accounting for about a third of total approvals. The non-residential approvals are led by a surge in education buildings and firm growth in retail outlets.

Rate cuts and a weaker NZ$ ahead

RBNZ is likely to cut its policy rate to 2.50% in December, and with little inflation ahead, and a slowing economy, one or two more rate cuts are possible in 2016. That will see the NZ$ ease on a rising US$ in 2016.

Calendar years	2012	2013	2014	2015	2016
GDP(Expenditure), real growth, %	2.9	2.5	3.0	2.7	2.4
GDP(Production), real growth, %	2.4	2.2	3.3	2.9	2.4
CPI, year average, %	1.1	1.1	1.2	0.3	1.2
Official cash rate, year end, %	2.50	2.50	3.50	2.50	2.00
NZ$1 = US$, year average	0.81	0.82	0.83	0.69	0.61
US$1 = NZ$, year average	1.23	1.22	1.20	1.45	1.65
NZ$1 = A$, year average	1.28	1.18	1.09	1.07	1.11

Source: 2012-2014 data from Statistics NZ; 2015-2016 forecasts by IMA Asia

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