McKinsey&Company

ASEAN Insights: Regional trends

March 2017

1. Global trends

GLOBAL ECONOMY SHOWS RESILIENCE AND RESURGENCE WITH STRONG BUSINESS SENTIMENT, ACCELERATION IN TRADE MOMENTUM

The global economy continued its strong performance in recent months, led by both manufacturing and services. Trade momentum continued its recent path of resurgence.

Global PMIs were strongly in the expansion zone, with the manufacturing PMI rising to a 69-month high of 52.9, driven by new orders and international trade. The global PMI for services also continued to expand robustly, albeit at a slightly slower pace than the last month. Output rose at the fastest rate since May 2011 for the eurozone, although growth moderated slightly in the United States and China.

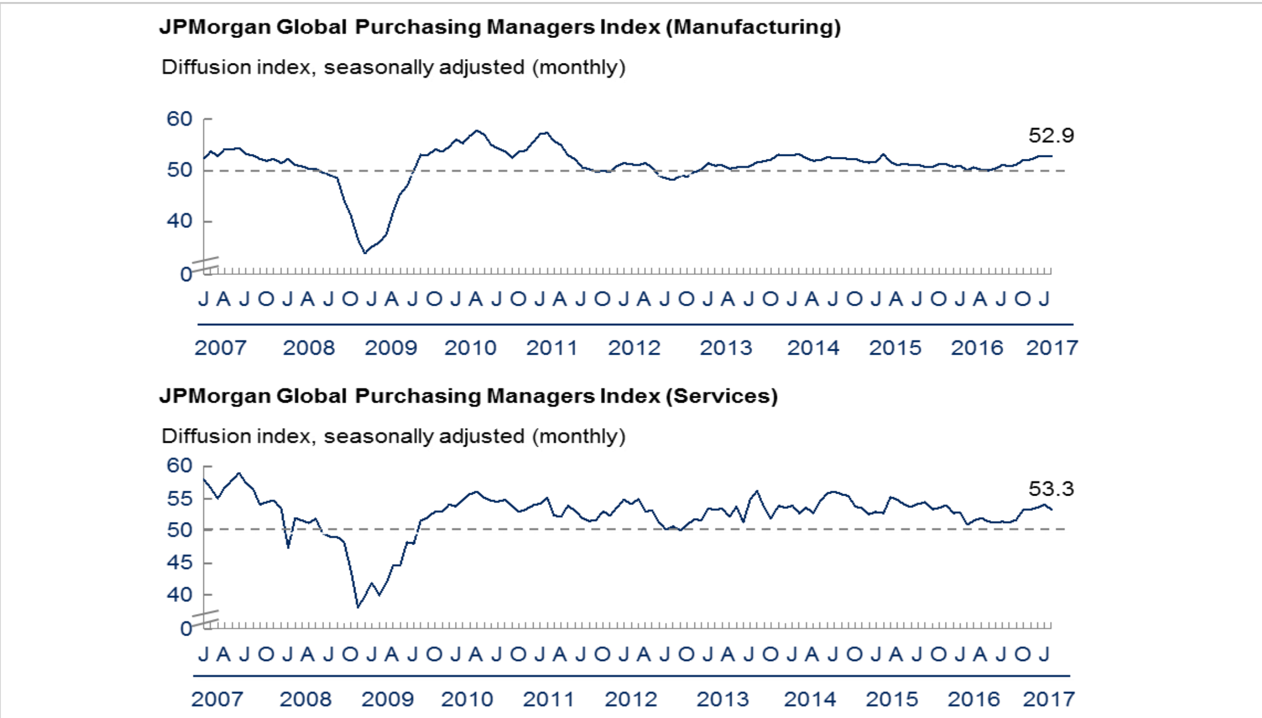
Global trade momentum strengthened, as both imports and exports continue to climb across all countries, with many ASEAN countries recording strong growth in trade volumes. The volume of world trade increased by 1.5 percent on a month-on-month basis in December.

Inflationary pressures increased in developed markets and eased in the emerging economies. Prices for steel and aluminum, in particular, picked up amid improved forecasts for both Chinese GDP growth and infrastructure investments in the US.

In terms of policy, the Trump administration has promised lower taxes, business deregulation, restructured trade deals, increased infrastructure spending, and closer ties with the energy industry. In the past month, Republican attempts to repeal and reform the Affordable Care Act have stalled amid intraparty disagreements. The debate over healthcare has prevented serious discussion of corporate tax reform and infrastructure spending. Notwithstanding the uncertainty, equities markets have surged nonetheless, with the S&P 500 reaching its all-time high in March.

The Federal Reserve raised its baseline interest rate for the third time since the financial crisis, with the federal funds rate now between 0.75 percent and 1.00 percent. In addition, the median expectation of Fed governors is for two additional rate increases this year.

Both manufacturing and services PMIs remain firmly in expansionary territory.



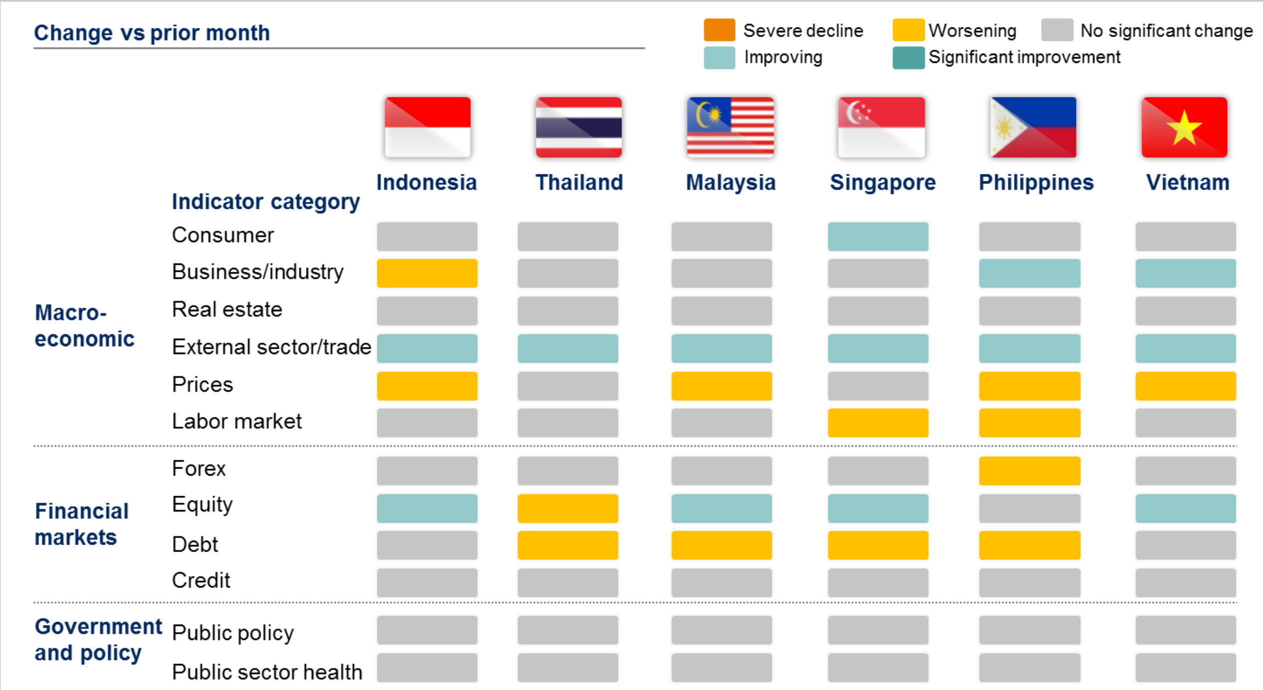
Note: A reading above 50.0 indicates expansionary conditions, while a reading under 50.0 indicates contractionary conditions.

SOURCE: JPMorgan, McKinsey Global Economics Intelligence Analysis

2. Regional trends: ASEAN

ASEAN ECONOMIES CONSOLIDATE GAINS AFTER RECENT ROBUST PERFORMANCES; BOND YIELDS RISE AS FED RAISES INTEREST RATES

Trade volumes continue to grow healthily but inflation becoming a concern



ASEAN economies showed signs of consolidation after strong outturns over the past few months. Retail sales continued to grow across the region, but the pace of growth slowed slightly from previous months. Retail sales growth in Indonesia, Malaysia, Thailand, and Vietnam moderated, while improving slightly in the Philippines and Singapore.

Macroeconomic trends

Industrial production generally grew at a slower pace, with manufacturing production growth in Malaysia moderating to 3.5 percent year-on-year in January, down from 4.7 percent the previous month.

External trade outcomes continued to grow strongly, with many countries continuing to record double-digit growth (or close to that level) in exports and imports. Exports from the Philippines, Malaysia, and Thailand grew strongly (22.5 percent, 13.6 percent and 8.8 percent year on year respectively) in January. Trade volume growth in Malaysia and Thailand was mainly driven by the electronics cluster. Exports from Indonesia increased by 11.6 percent in February.

Inflation is becoming a concern for many ASEAN countries, in part driven by imported inflation as a result of the strong US dollar.

Inflation in Indonesia accelerated to 3.8 percent in February, from 3.5 percent last month, and rose from 2.7 percent to 3.3 percent in the Philippines. Consumer prices in Malaysia and Singapore also rose by 3.2 percent and 0.6 percent respectively in January, compared with 1.8 percent and 0.2 percent in December.

Leading indicators were mixed. Vietnam's manufacturing PMI rose to 54.2 in February from 51.9 in January, while Philippines' PMI climbed to 53.6. Although Malaysia's PMI rose to 49.4 it remains in contractionary territory; Indonesia's February PMI fell to 49.3 from 50.4 in January.

Financial markets

Benchmark bond yields rose substantially for most ASEAN countries, in light of hawkish statements from the Federal Reserve and the hike in interest rates.

Government policy

Indonesia's central bank, Bank Indonesia, signaled that its benchmark rate is "low enough"—after six interest rate cuts last year—and Bank Negara Malaysia left its benchmark rate unchanged, as central banks wait and observe market reactions to the US interest rate rise.

SOURCE: CEIC, McKinsey Global Economics Intelligence Analysis

3. ASEAN Insights: Country analysis

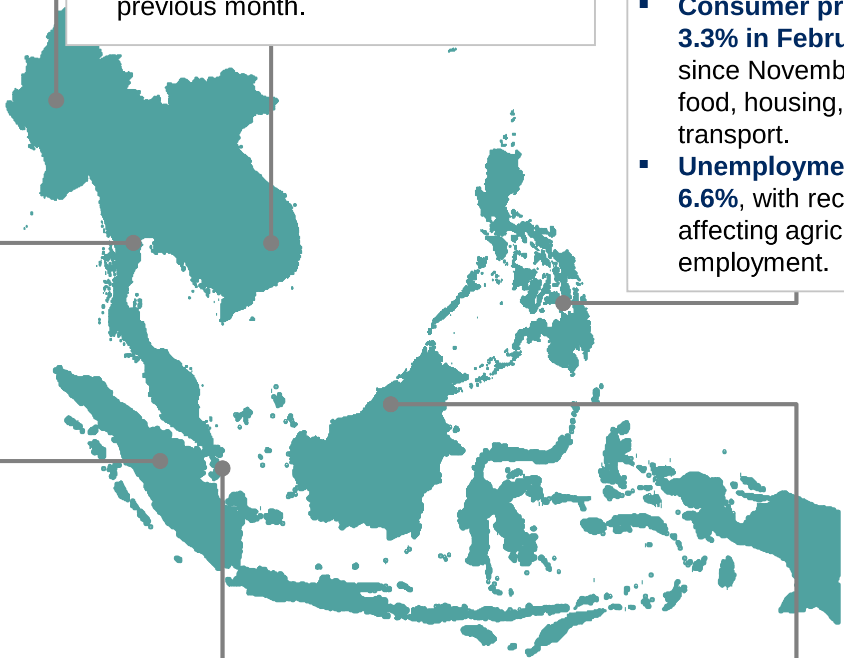
THE REGION AT A GLANCE

MYANMAR
- **The manufacturing PMI inched up to a 13-month high of 51.9** in February, up from 51.7 the previous month.
- **Business cost pressures persisted,** contributing to substantial inflation.

THAILAND
- **Trade volumes rose,** with exports and imports climbing by 8.8% and 5.2% respectively in January.
- **Industrial production rose by 1.3%** year-on-year in January, faster than the 0.5% December increase.
- **The manufacturing PMI stood** at 50.6 in February, remaining in expansionary territory.
- **Retail sales in Thailand grew by 1.3% year-on-year** in December, after a 6.4% rise last month.

VIETNAM
- **Economic conditions are positive but inflation remains high.**
- **Retail sales rose by 7.2%** year-on-year in February, following a 9.9% increase the prior month.
- **Manufacturing PMI rose to 54.2** in February, up from 51.9 in January. **Industrial production jumped by 15.2%** year-on-year, the strongest increase in two years.
- **Inflation moderated slightly to 5.0% in February,** down from 5.2% the previous month.

PHILIPPINES
- **Inflationary pressures continue to build, although economic environment is still resilient.**
- **Manufacturing production rose by 11.6%** year-on-year in January, moderating from a 19.4% rise in December. However, the outlook brightened, with PMI rising from 52.7 in January to 53.6 in February.
- **Consumer prices rose by 3.3% in February**, the highest since November 2014, led by food, housing, utilities, and transport.
- **Unemployment rate rose to 6.6%**, with recent typhoons affecting agricultural employment.



INDONESIA
- **Trade volumes continue to grow, but economic conditions slightly weaken.**
- **Exports jumped 11.2%** year-on-year in February, with sales to ASEAN trading partners rising, delivering a fifth consecutive month of increase, which nonetheless missed market estimates of 15.2% growth.
- **Inflation accelerated to 3.8% in January**, following a 3.5% gain the previous month.
- **Manufacturing PMI in Indonesia dropped into contractionary territory in February,** coming in at 49.3, down from 50.4 in January.

SINGAPORE
- **Retail sales grew by 2.0%** year-on-year in January, up from a 0.7% increase in December and beating market estimates of a 0.5% fall.
- **Singapore's inflation continued its recovery from deflation,** reaching 0.6% in January, the highest since September 2014.
- **Labor market conditions in Singapore remain very challenging**, with the seasonally-adjusted unemployment rate for Singapore citizens rising to 3.5% in Q4 2016, up from 3.0% in Q3. This was the highest figure since the Global Financial Crisis.

MALAYSIA
- **Trade volumes went up strongly,** with exports recording growth of 13.6% in January.
- **Retail sales growth moderated slightly**, rose by 9.0% year-on-year in January, down from 9.7% the previous month.
- **Industrial production rose 3.5%** year-on year-in January, compared with a 4.7% growth in December. **However, Malaysia's PMI rose to 49.4 in February**, up from 48.6 last month, although it remains in contractionary territory.
- **Inflation rose to 3.2%** in January, an 11-month high.

SOURCE: McKinsey Global Economics Intelligence Analysis

Indonesia

TRADE VOLUMES GROW BUT ECONOMIC CONDITIONS WEAKEN SLIGHTLY; EQUITY MARKETS HIT RECORD HIGH

Trade volumes rose strongly in February, in line with positive outcomes seen in the rest of the region. Exports continued to grow by double digits in February, rising by 11.2 percent year-on-year. This was the fifth consecutive month of increase, although figures missed market estimates of a 15.2 percent rise; growth was driven by an increase in sales to ASEAN countries. Meanwhile, imports rose by 10.6 percent, led by an increase in purchases of oil and gas.

The manufacturing PMI came in at 49.3 in February, falling back into contractionary territory. This contrasted with the 50.4 figure seen in January, which had been the first expansion since September last year.

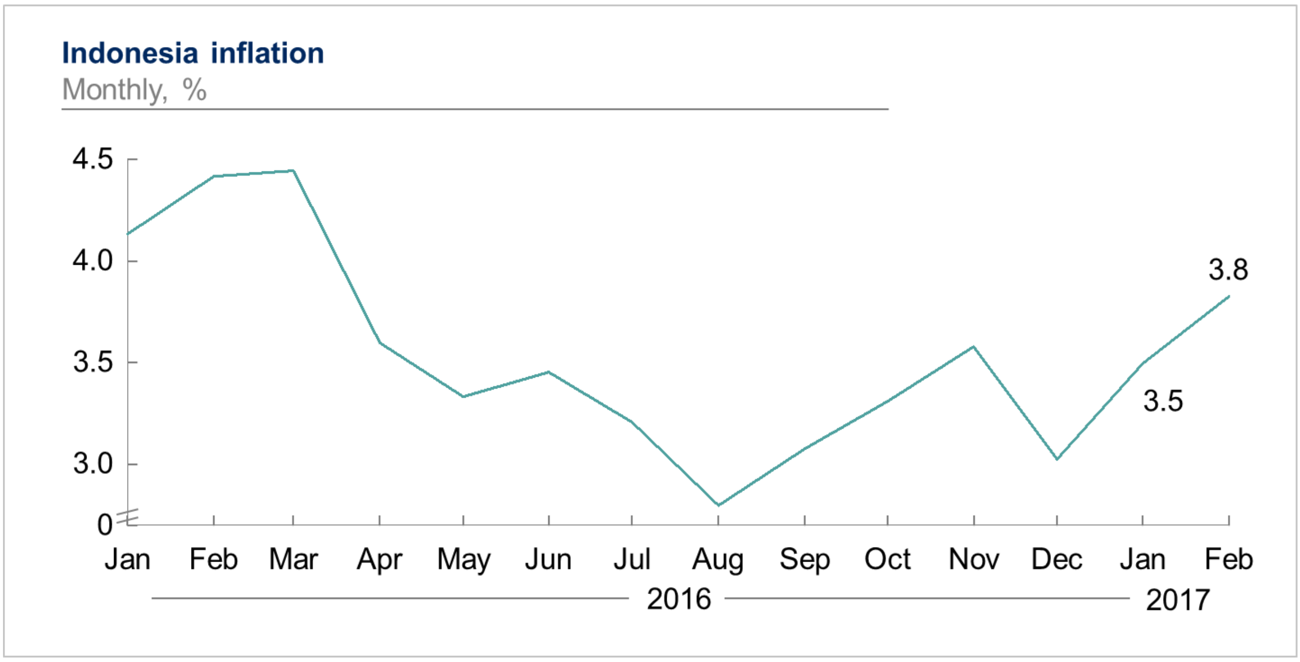
Retail sales also grew at a slower pace, rising by 6.3 percent year-on-year in January, compared with a 10.5 percent gain the preceding month. It was the lowest growth since July last year, as sales rose at a slower pace for food, beverages, and tobacco. This may have been attributable to a 10.5 percent increase in tobacco excise duty, which came into effect from the beginning of the year.

The rise in tobacco excise duty, together with a cut in domestic electricity subsidy and some upward adjustments in administered prices for fuels, pushed inflation up to 3.8 percent in February. In addition, some food commodities have seen higher prices due to flooding of production areas.

On the financial market front, Indonesia's benchmark stock index, the Jakarta Composite Index, performed well this month, reaching an all-time high on 17 March. This was driven by a return in foreign investor appetite. The recent rally in Indonesia stocks has also been driven by expectations that S&P will upgrade the country to investment grade this year, with Moody's and Fitch already giving Indonesia an investment grade rating.

Indonesia's central bank, Bank Indonesia (BI) kept monetary policy unchanged. In addition, BI signaled that the current benchmark rate is "low enough," after six interest rate cuts last year.

Indonesia's inflation has risen recently



SOURCE: CEIC, McKinsey Global Economics Intelligence Analysis

Thailand

ECONOMIC RECOVERY REMAINS ON TRACK

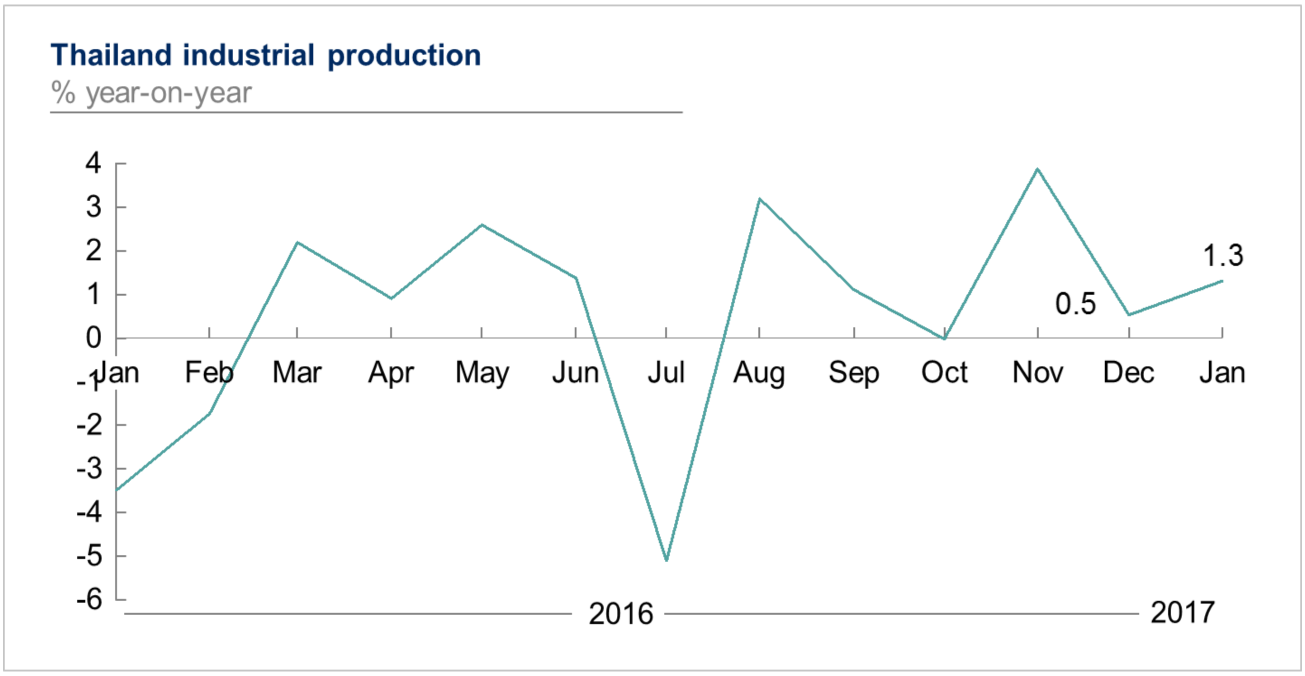
Indicators suggest resilience within the Thai economy. Exports rose by 8.8 percent year-on-year in January, while imports went up by 5.2 percent. Exports were driven by increasing sales of electronics, gold, and rubber. The recent recovery in imports has suggested that the industrial sector, which imports raw materials and inputs for manufactured exports, has recovered.

Reflecting this, Thailand recorded a 1.3 percent year-on-year rise in industrial production for January, faster than the 0.5 percent increase in December. Production of electrical machinery and apparatus grew strongly, likely reflecting an increase in external demand (as seen in data for electronics exports). Moreover, the manufacturing PMI stood at 50.6 in February, unchanged from the previous month and the third consecutive month of expansion.

Retail sales growth moderated, growing by 1.3 percent year-on-year in December, slower than the 6.4 percent rise in the previous month. However, this was higher than the 1.2 decline in October, with retail sales growth remaining volatile in the wake of the death of King Bhumibol in October.

Bucking the trend in the rest of the region, inflation moderated slightly to 1.44 percent in February, after reaching 1.55 percent last month, the highest since September 2014. Nonetheless, inflation is likely to pick up over the coming months as a result of rising commodity prices. Inflation is now within the target range of 1 to 4 percent set by Thailand's central bank, the Bank of Thailand, after undershooting it in 2015 and most of 2016.

Thailand recorded a small increase in industrial production in January



Malaysia

ECONOMIC INDICATORS MIXED; TRADE VOLUMES INCREASE STRONGLY

The Malaysian economy showed mixed performance this month.

Trade volumes continued to grow strongly, in line with the rest of the region. Exports grew 12.0 percent in January, again recording double-digit growth. The expansion in January was broad-based, with increases in exports of electronics, rubber, palm oil and palm-based products, as well as crude oil. Exports to Malaysia's top three trading partners (China, Singapore, and the European Union) also recorded double-digit increases.

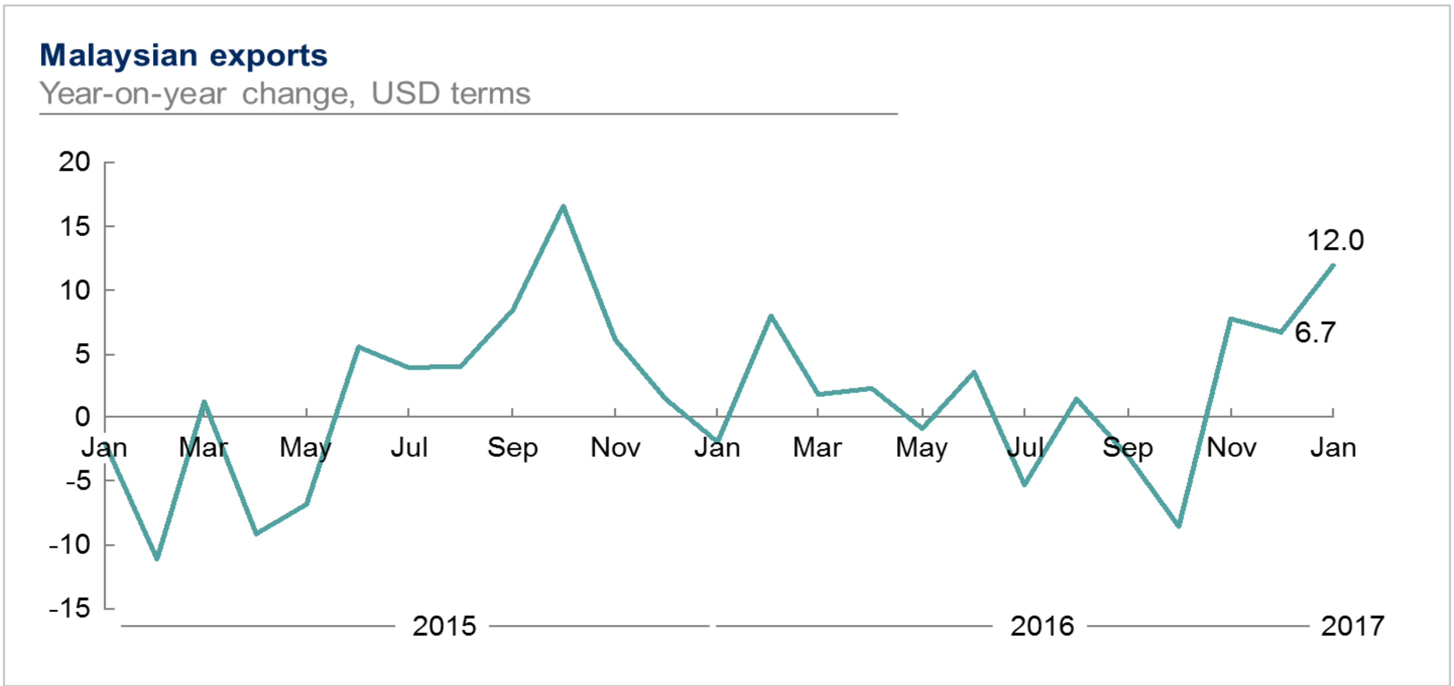
Retail sales growth moderated slightly, going up by 9.0 percent year-on-year in January, down from 9.7 percent the previous month. Industrial production growth also ticked down to 3.5 percent, following 4.7 percent growth in December.

While still low, manufacturing activity contracted at a slower rate. The manufacturing PMI for Malaysia rose at 49.4 in February, up from 48.6 in December.

Consumer prices jumped by 3.2 percent in January 2017—a marked increase from December 2016's rate of 1.8 percent. It was the highest rate of inflation since February 2016, mainly driven by faster increases in food and a surge in transport costs. Recent food price increases have been underpinned by the removal of cooking oil subsidies in November last year, while the surge in transport costs came about after a government-sanctioned increase in retail fuel prices came into effect from the start of this year. Petrol prices went up by 6.7 to 10.5 percent, depending on the fuel type.

On the government policy front, Malaysia's central bank, Bank Negara Malaysia left its benchmark interest rate unchanged at 3 percent as expected, following a monetary policy meeting this month. BNM said that cost-driven inflation (such as oil prices) is not expected to have a significant impact on broader price trends, given stable domestic demand conditions.

Malaysian exports grew strongly in January



SOURCE: CEIC, McKinsey Global Economics Intelligence Analysis

Philippines

INFLATIONARY PRESSURES CONTINUE TO BUILD BUT ECONOMIC ENVIRONMENT STILL RESILIENT

The Filipino economy saw inflationary pressures continue to build. Consumer prices rose by 3.3 percent in February, led by food, utilities, and transport prices – the highest rate since November 2014. Inflationary pressures have picked up in the Philippines as a result of firmer global commodity and energy prices. In addition, recent hawkish comments prior to the March interest rate increase by the US Federal Reserve have led the Philippine peso to depreciate around 0.8 percent against the US dollar in the past month, contributing to import inflation.

Nonetheless, together with many emerging market currencies, the Philippine peso appreciated against the US dollar after unexpectedly dovish comments by the Fed regarding the pace of future rate increases.

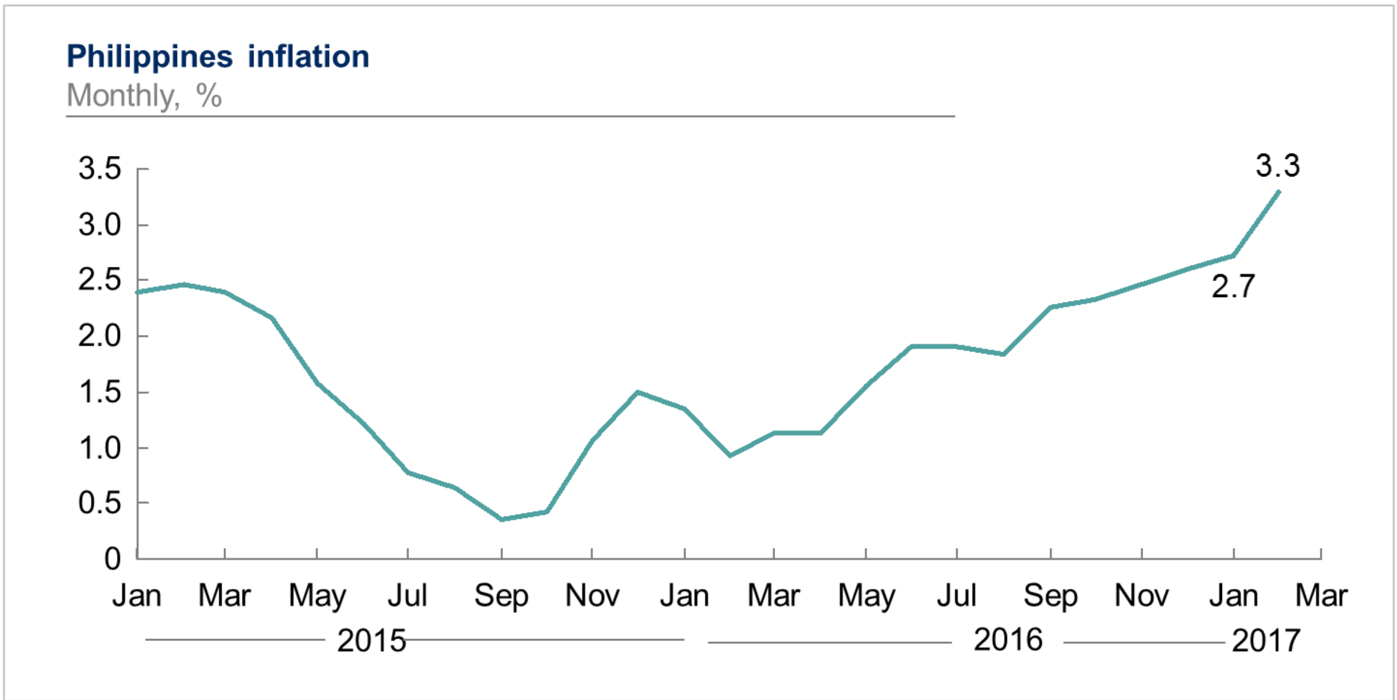
The Philippines also saw its first quarterly current account deficit since Q1 2012, as the recent rise in importation of capital goods and raw materials ahead of heavy infrastructure build up overwhelmed inflows from trade and remittances.

The unemployment rate rose to 6.6 percent in January this year, higher than the 5.7 percent recorded in the same period a year ago. This was mainly attributable to employment losses in the agriculture sector (which accounts for more than 25 percent of employment). The agriculture sector was affected by typhoons Nina and Auring, which hit in December 2016 and January 2017.

On a brighter note, consumer sentiment was resilient, with retail sales growing 4.4 percent year-on-year in January, marginally higher than the 4.3 percent growth recorded in the previous month.

Manufacturing production growth moderated, but still rose at a considerable 11.6 percent year-on-year in January, after growing 19.4 percent in December, and reversing a 2.7 percent decline the previous month. The manufacturing PMI brightened, rising from 52.7 in January to 53.6 in February.

Philippines' inflation rate has been gradually creeping up over the past few months



SOURCE: CEIC, McKinsey Global Economics Intelligence Analysis

Singapore

TRADE VOLUMES CONTINUE TO REBOUND STRONGLY BUT LABOR MARKET REMAINS WEAK; INFLATION PICKS UP

Manufacturing production in Singapore saw growth of 12.6% year-on-year in February, up from 3.8% last month. However, figures were skewed by a favorable base effect, due to Chinese New Year falling in February last year but January this year. On a month-on-month seasonally-adjusted basis, output fell 3.7%.

Manufacturing PMI edged down slightly to 50.9 in February, from 51.0 in January. Singapore's non-oil domestic exports rose 21.5 percent year-on-year in February, again skewed by the Chinese New Year effect. On a seasonally adjusted month-on-month basis, exports rose by 1.4 percent, compared with 5 percent recorded last month.

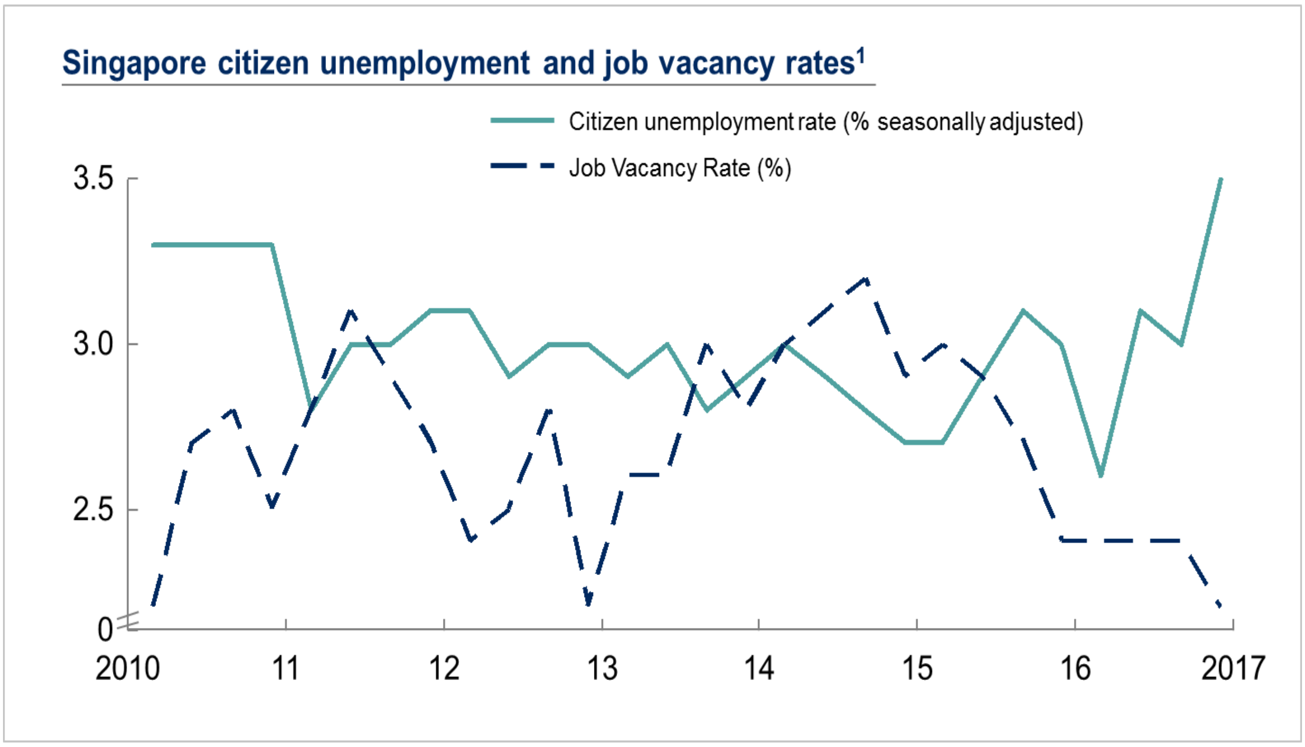
The Singapore labor market performed dismally, with the seasonally adjusted overall unemployment rate rising to 2.2 percent in Q4, its highest since 2010. The seasonally adjusted Singapore citizen unemployment rate rose by 0.5 percentage points to 3.5 percent, the highest since 2009. Job vacancy rates fell to its lowest level since the global financial crisis period, while the number of retrenchments and long-term unemployed went up. Notably, graduates saw long-term unemployment rate of 1 percent in 2016, the highest since 2004.

Inflation picked up to 0.6 percent. After exiting deflation in late 2016, inflation is likely to continue on its upward trend in the near-term. This will be driven by a recovery in oil prices, and a 30 percent increase in water prices that will be implemented over two phases in 2017 and 2018.

On the financial and asset market front, the Straits Times Index rose this month, continuing its recent good performance. Benchmark ten-year bond yields rose by around 25 basis points, a result of the interest rate hike by the US Federal Reserve.

On government policy, Singapore announced a slight easing in property cooling measures, with a reduction in the stamp duty paid by sellers of residential property, specifically for those who have owned a property for more than three years, trimming the previous four-year threshold. Stamp duty rates have also been reduced by four percentage points. Other measures such as loan-to-value limits on mortgages and additional buyers' stamp duties were maintained.

Labor market conditions are very challenging



1 Job vacancy rate is defined as the total number of job vacancies divided by the total demand for manpower at the end of the quarter. The total demand for manpower is defined as the sum of the number of employees and job vacancies.

SOURCE: CEIC, McKinsey Global Economics Intelligence Analysis

Vietnam

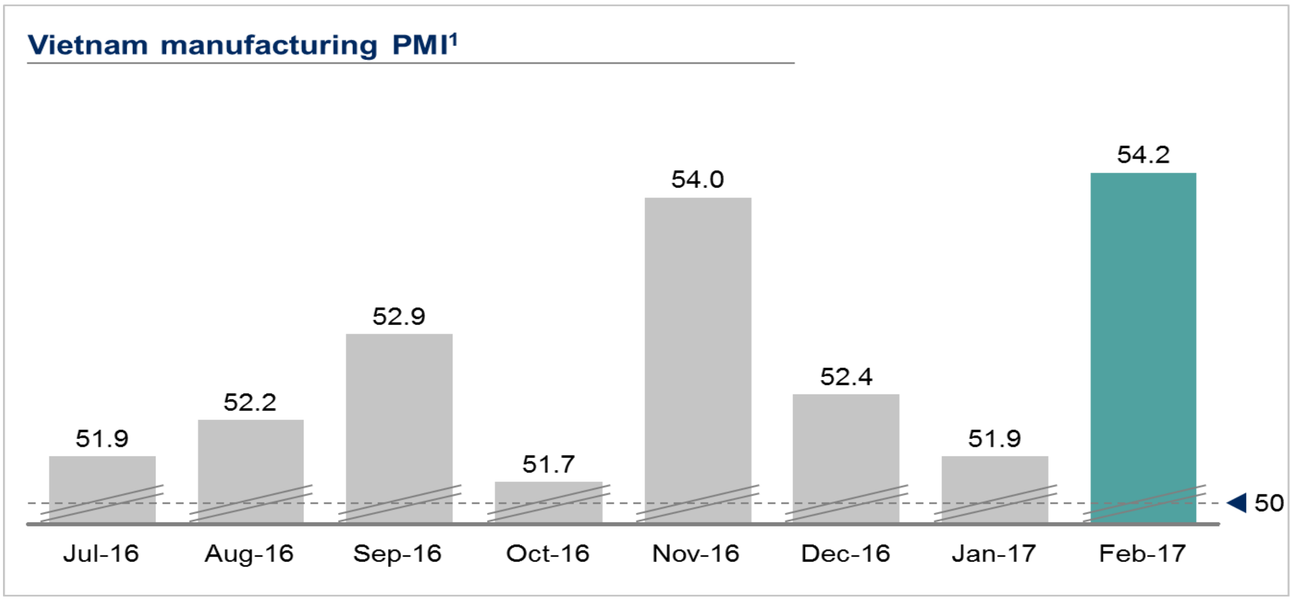
ECONOMIC CONDITIONS POSITIVE; INFLATION MODERATES SLIGHTLY BUT REMAINS HIGH

Economic conditions in Vietnam were positive: industrial production surged 15.2 percent year-on-year in February, while manufacturing PMI rose to 54.2. Manufacturing PMI was at its strongest since May 2015, as output and new orders accelerated.

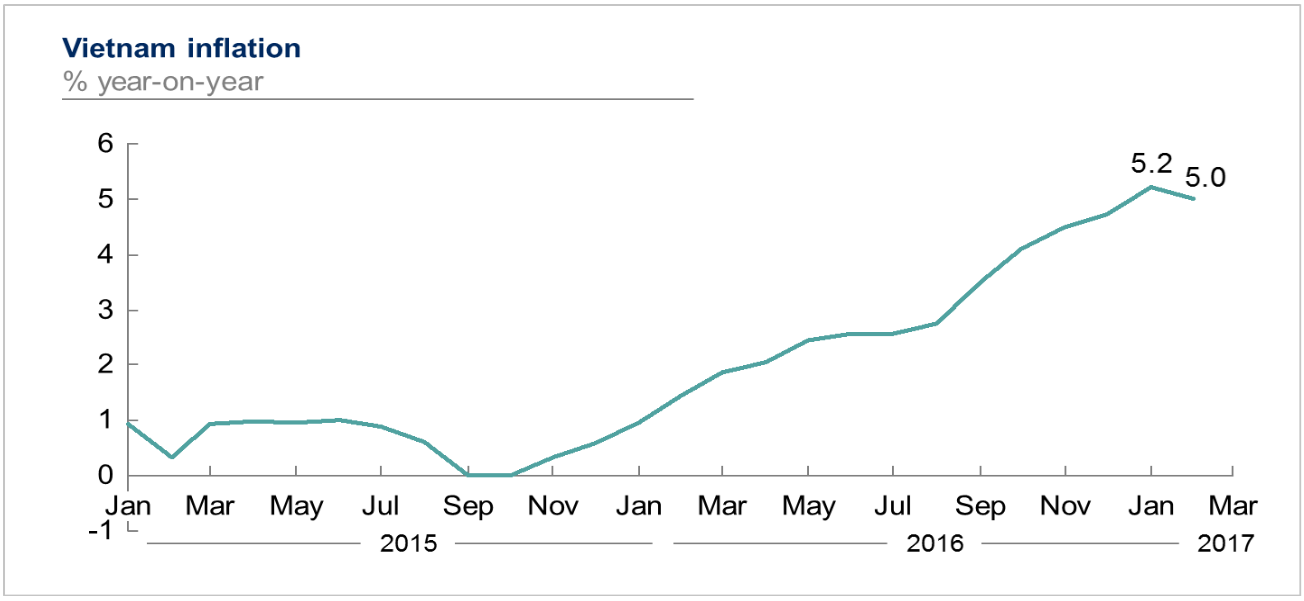
Consumer sentiment weakened slightly but remains strong, with retail sales growing by 7.2 percent year-on-year in February, after a 9.9 percent rise during the previous month.

Inflation moderated to 5.0 percent in February, after increasing sharply in recent months. Inflation is likely to moderate over coming months as the year-on-year impact of last year's government cut to healthcare subsidies dissipate as from next month. This cut has added around two percentage points to inflation every month since March 2016.

Business conditions improved strongly in February



Price pressures moderate slightly but remain high



1 A reading above 50 indicates an expansion of the manufacturing sector compared with the previous month; below 50 represents a contraction; while 50 indicates no change.

SOURCE: CEIC, McKinsey Global Economics Intelligence Analysis

Myanmar

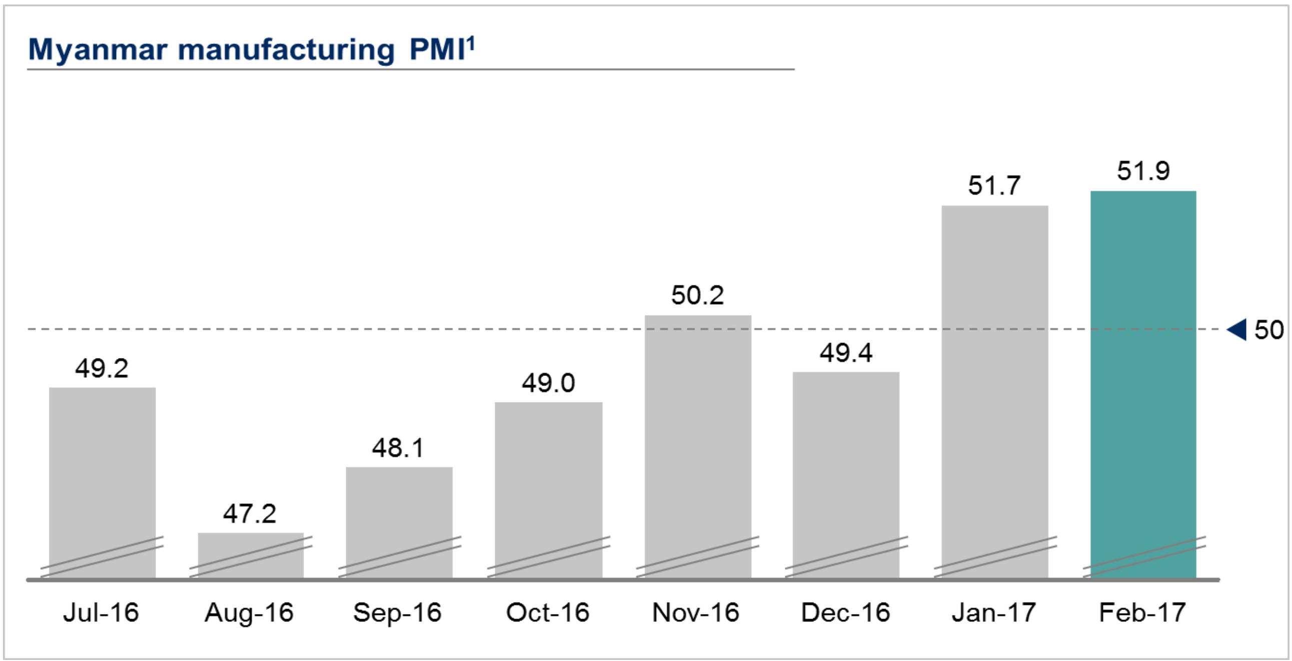
BUSINESS CONDITIONS IMPROVE AT FASTEST RATE IN OVER A YEAR, BUT BUSINESS COST PRESSURES PERSIST

Conditions in Myanmar appear to be improving, following a challenging 2016.

Manufacturing conditions continued their positive start to 2017, with headline PMI reaching a 13-month high of 51.9 in February. This uptick was driven both by expansions in production and new business, with reports of greater demand driven by government projects.

Nonetheless, there continues to be spare capacity, with a further steep reduction in backlogs of work. Inflationary pressures remain marked with exchange rate instability being the principal driver of input cost inflation. Firms continue to see margin compression as selling prices remain stagnant due to competitive pressures. However, a continuation of higher input costs will lead to further supply chain pressures and ultimately pass through to consumers in the form of higher prices.

The manufacturing PMI posted a marked improvement



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