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Understanding ASEAN: Seven things you need to know

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Southeast Asia is one of the world's fastest-growing markets—and one of the least well known.

China remains the Goliath of emerging markets, with every fluctuation in its GDP making headlines around the globe. But investors and multinationals are increasingly turning their gaze southward to the ten dynamic markets that make up the Association of Southeast Asian Nations (ASEAN). Founded in 1967, ASEAN today encompasses Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Vietnam—economies at vastly different stages of development but all sharing immense growth potential. ASEAN is a major global hub of manufacturing and trade, as well as one of the fastest-growing consumer markets in the world. As the region seeks to deepen its ties and capture an even greater share of global trade, its economic profile is rising—and it is crucial for those outside the region to understand its complexities and contradictions. The seven insights below offer a snapshot of one of the world's most diverse, fast-moving, and competitive regions.

1. Together, ASEAN's ten member states form an economic powerhouse.

If ASEAN were a single country, it would already be the seventh-largest economy in the world, with a combined GDP of $2.4 trillion in 2013 (Exhibit 1). It is projected to rank as the fourth-largest economy by 2050.[1]

[1] Based on forecasts by IHS.

Exhibit 1 ASEAN is one of the largest economic zones in the world; growth has been rapid and relatively stable since 2000.

GDP 2013, current prices $ trillion		**Real GDP growth, 2000–13** %		**GDP growth volatility,[1] 2000–13** %		**Share of debt to GDP, 2013** %		**Inflation rate, 2013** %, GDP deflator	
United States	16.8	China	10.0	Russia	4.2	Japan	243	India	7.0
China	9.3	India	7.0	India	2.4	Italy	133	Russia	6.5
Japan	4.9	**ASEAN**	**5.1**	United Kingdom	2.3	United States	105	Brazil	6.5
Germany	3.6	Russia	4.4	Italy	2.3	France	94	**ASEAN**	**2.8**
France	2.7	Brazil	3.2	Germany	2.3	United Kingdom	90	Germany	2.3
United Kingdom	2.5	Canada	1.9	Japan	2.2	Canada	89	United Kingdom	2.1
ASEAN[2]	**2.4**	United States	1.8	Brazil	2.2	Germany	78	China	1.7
Brazil	2.2	United Kingdom	1.5	China	1.8	India	67	United States	1.5
Russia	2.1	Germany	1.1	United States	1.7	Brazil	66	Canada	1.5
Italy	2.1	France	1.0	Canada	1.7	**ASEAN**	**47**	Italy	1.4
India	1.9	Japan	0.8	France	1.6	China	22	France	1.1
Canada	1.8	Italy	0.0	**ASEAN**	**1.5**	Russia	13	Japan	–0.6

[1] Standard deviation of GDP growth rate.
[2] Association of Southeast Asian Nations.

Source: IHS; International Monetary Fund, *World Economic Outlook*; McKinsey Global Institute analysis

Labor-force expansion and productivity improvements drive GDP growth—and ASEAN is making impressive strides in both areas. Home to more than 600 million people, it has a larger population than the European Union or North America. ASEAN has the third-largest labor force in the world, behind China and India; its youthful population is producing a demographic dividend. Perhaps most important, almost 60 percent of total growth since 1990 has come from productivity gains, as sectors such as manufacturing, retail, telecommunications, and transportation grow more efficient.

To capitalize on these trends, however, the region must develop its human capital and workforce skills. In Indonesia and Myanmar alone, we project an undersupply of 9 million skilled and 13 million semiskilled workers by 2030.[2]

2. ASEAN is not a monolithic market.

ASEAN is a diverse group. Indonesia represents almost 40 percent of the region's economic output and is a member of the G20, while Myanmar, emerging from decades of isolation, is still a frontier market working to build its institutions. GDP per capita in Singapore, for instance, is more than 30 times higher than in Laos and more than 50 times higher than in Cambodia and Myanmar; in fact, it even surpasses that of mature economies such as Canada and the United States. The standard deviation in average incomes among ASEAN countries is more than seven times that of EU member states. That diversity extends to culture, language, and religion. Indonesia, for example, is almost 90 percent Muslim, while the Philippines is more than 80 percent Roman Catholic, and Thailand is more than 95 percent Buddhist. Although ASEAN is becoming more integrated, investors should be aware of local preferences and cultural sensitivities; they cannot rely on a one-size-fits-all strategy across such widely varying markets.

3. Macroeconomic stability has provided a platform for growth.

Memories of the 1997 Asian financial crisis linger, leading many outsiders to expect that volatility comes with the territory. But the region proved to be remarkably resilient in the aftermath of the 2008 global financial crisis, and today it is in a much stronger fiscal position: government debt is under 50 percent of GDP—far lower than the 90 percent share in the United Kingdom or 105 percent in the United States.

Most of the region has held steady so far, despite concern about the effect on emerging markets of the potential end of quantitative easing by the US Federal Reserve. In fact, ASEAN has experienced much lower volatility in economic growth since 2000 than the European Union. Savings levels have also remained fairly steady since 2005, at about a third of GDP, albeit with large differences between high-saving economies, such as Brunei, Malaysia, and Singapore, and low-saving economies, such as Cambodia, Laos, and the Philippines.

4. ASEAN is a growing hub of consumer demand.

ASEAN has dramatically outpaced the rest of the world on growth in GDP per capita since the late 1970s. Income growth has remained strong since 2000, with average annual real gains of more than 5 percent. Some member nations have grown at a torrid pace: Vietnam, for example, took just 11 years (from 1995 to 2006) to double its per capita GDP from $1,300 to $2,600. Extreme poverty is rapidly receding. In 2000, 14 percent of the region's

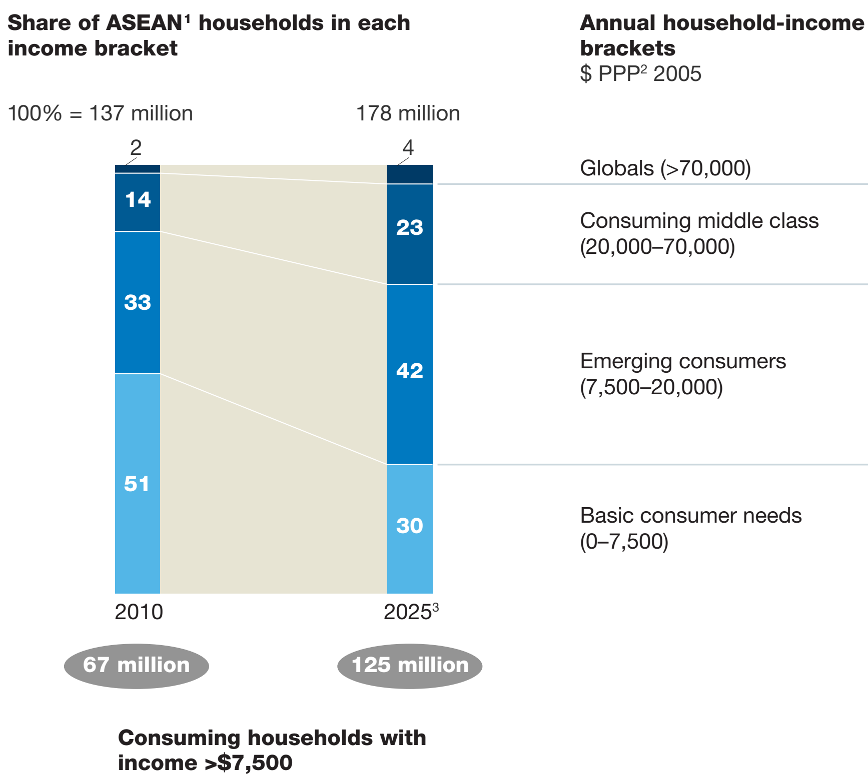
[2] For further details, see the McKinsey Global Institute's reports *The archipelago economy: Unleashing Indonesia's potential*, September 2012, and *Myanmar's moment: Unique opportunities, major challenges*, June 2013, on mckinsey.com.

population was below the international poverty line of $1.25 a day (calculated in purchasing-power-parity terms), but by 2013, that share had fallen to just 3 percent.

Already some 67 million households in ASEAN states are part of the "consuming class," with incomes exceeding the level at which they can begin to make significant discretionary purchases (Exhibit 2).[3] That number could almost double to 125 million households by 2025, making ASEAN a pivotal consumer market of the future. There is no typical ASEAN consumer, but some broad trends have emerged: a greater focus on leisure activities, a growing preference for modern retail formats, and increasing brand awareness (Indonesian consumers, for example, are exceptionally loyal to their favorite brands).[4]

[3] Defined as households with more than $7,500 in annual income (in purchasing-power-parity terms).
[4] Arief Budiman et al., *The new Indonesian consumer*, December 2012, csi.mckinsey.com.

Exhibit 2 The number of consuming households in ASEAN is expected to almost double by 2025.



[1] Association of Southeast Asian Nations; excludes Brunei.
[2] Purchasing power parity adjusts for price differences in identical goods across countries to reflect differences in purchasing power in each country.
[3] Forecast; figures may not sum, because of rounding.

Source: McKinsey Global Institute Cityscope database; McKinsey Global Institute analysis

Urbanization and consumer growth move in tandem, and ASEAN's cities are booming. Today, 22 percent of ASEAN's population lives in cities of more than 200,000 inhabitants—and these urban areas account for more than 54 percent of the region's GDP. An additional 54 million people are expected to move to cities by 2025. Interestingly, the region's midsize cities have outpaced its megacities in economic growth. Nearly 40 percent of ASEAN's GDP growth through 2025 is expected to come from 142 cities with populations between 200,000 and 5 million.

ASEAN consumers are increasingly moving online, with mobile penetration of 110 percent and Internet penetration of 25 percent across the region. Its member states make up the world's second-largest community of Facebook users, behind only the United States. But there are vast differences in adoption. Hyperconnected Singapore has the fourth-highest smartphone penetration in the world, and almost 75 percent of its population is online. By contrast, only 1 percent of Myanmar has access to the Internet. Indonesia, with the world's fourth-largest population, is rapidly becoming a digital nation; it already has 282 million mobile subscriptions and is expected to have 100 million Internet users by 2016.

5. ASEAN is well positioned in global trade flows.

ASEAN is the fourth-largest exporting region in the world, trailing only the European Union, North America, and China/Hong Kong. It accounts for 7 percent of global exports—and as its member states have developed more sophisticated manufacturing capabilities, their exports have diversified. Vietnam specializes in textiles and apparel, while Singapore and Malaysia are leading exporters of electronics. Thailand has joined the ranks of leading vehicle and automotive-parts exporters. Other ASEAN members have built export industries around natural resources. Indonesia is the world's largest producer and exporter of palm oil, the largest exporter of coal, and the second-largest producer of cocoa and tin. While Myanmar is just beginning to open its economy, it has large reserves of oil, gas, and precious minerals. In addition to exporting manufactured and agricultural products, the Philippines has established a thriving business-process-outsourcing industry. China, a competitor, has become a customer. In fact, it is now the most important export market for Malaysia and Singapore. But demand from the United States, Europe, and Japan continues to propel growth.[5]

Export-processing zones, once dominated by China, have been established across ASEAN. The Batam Free Trade Zone (Singapore–Indonesia), the Southern Regional Industrial Estate (Thailand), the Tanjung Emas Export Processing Zone (Indonesia), the Port Klang Free Zone (Malaysia), the Thilawa Special Economic Zone (Myanmar), and the Tan Thuan Export Processing Zone (Vietnam) are all expected to propel export growth.

[5] "Ten of Asia's most dynamic export processing zones that you've never heard of," *Asia Briefing*, April 24, 2014, asiabriefing.com.

The region sits at the crossroads of many global flows. Singapore is currently the fourth-highest-ranked country in the McKinsey Global Institute's Connectedness Index, which tracks inflows and outflows of goods, services, finance, and people, as well as the underlying flows of data and communication that enable all types of cross-border exchanges.[6] Malaysia (18th) and Thailand (36th) also rank among the top 50 most connected countries. ASEAN is well positioned to benefit from growth in all these global flows. By 2025, more than half of the world's consuming class will live within a five-hour flight of Myanmar.

6. Intraregional trade could significantly deepen with implementation of the ASEAN Economic Community, but there are hurdles.

Some 25 percent of the region's exports of goods go to other ASEAN partners, a share that has remained roughly constant since 2003. While this is less than half the share of intraregional trade seen in the North American Free Trade Agreement countries of Canada, Mexico, and the United States and in the European Union, the total value is climbing rapidly as the region develops stronger cross-border supply chains.

Intraregional trade in goods—along with other types of cross-border flows—is likely to increase with implementation of the ASEAN Economic Community integration plan, which aims to allow the freer movement of goods, services, skilled labor, and capital. Progress has been uneven, however. While tariffs on goods are now close to zero in many sectors among the original six member states (Brunei, Indonesia, Malaysia, the Philippines, Singapore, and Thailand), progress on liberalization of services and investment has been slower, and nontariff barriers remain a stumbling block to freer trade.

While deeper integration among its member states remains a work in progress, ASEAN has forged free-trade agreements elsewhere with partners that include Australia, China, India, Japan, New Zealand, and South Korea. It is also party to the Regional Comprehensive Economic Partnership trade negotiations that would form a megatrading bloc comprising more than three billion people, a combined GDP of about $21 trillion, and some 30 percent of world trade.

7. ASEAN is home to many globally competitive companies.

In 2006, ASEAN was home to the headquarters of 49 companies in the Forbes Global 2000. By 2013, that number had risen to 74. ASEAN includes 227 of the world's companies with more than $1 billion in revenues, or 3 percent of the world's total (Exhibit 3). Singapore is a standout, ranking fifth in the world for corporate-headquarters density and first for foreign subsidiaries.[7]

[6] For further details, see the full McKinsey Global Institute report, *Global flows in a digital age: How trade, finance, people, and data connect the world economy*, April 2014, on mckinsey.com.

[7] Headquarters density is the ratio of the revenue of all large companies (defined as those with revenue of $1 billion or more) headquartered in a given country to that country's GDP in 2010. For further details, see the full McKinsey Global Institute report, *Urban world: The shifting global business landscape*, October 2013, on mckinsey.com.

Exhibit 3 ASEAN is home to 227 of the world's largest companies; combined, it would be the seventh-largest host of such companies.

2010		Number of companies[1]	Company revenue $ billion	Average revenue per company $ billion
1	United States	2,123	15,221	7.2
2	Japan	1,028	7,347	7.1
3	China	674	6,208	9.2
4	Germany	463	3,729	8.1
5	United Kingdom	358	2,818	7.9
6	France	236	3,075	13.0
	ASEAN[2]	227	1,068	**4.7**
7	Australia	203	960	4.7
8	Canada	194	1,071	5.5
9	Italy	179	1,149	6.4
10	Russia	165	924	5.6
11	India	158	898	5.7
12	South Korea	151	1,398	9.3
13	Switzerland	140	1,308	9.3
23	**Singapore**	64	343	**5.4**
28	**Thailand**	51	259	**5.1**
31	**Malaysia**	40	193	**4.8**
36	**Indonesia**	33	136	**4.1**
43	**Vietnam**	20	90	**4.5**
44	**Philippines**	19	47	**2.5**

[1] Data only for headquarters of companies with more than $1 billion in revenue in 2010.
[2] Association of Southeast Asian Nations.

Source: McKinsey Global Institute Cityscope database; McKinsey Global Institute analysis

Consistent with this growth, foreign direct investment in ASEAN has boomed, surpassing its precrisis levels. In fact, the ASEAN-5 (Indonesia, Malaysia, the Philippines, Singapore, and Thailand) attracted more foreign direct investment than China ($128 billion versus $117 billion) in 2013.[8] In addition to attracting multinationals, ASEAN has become a launching pad for new companies; the region now accounts for 38 percent of Asia's market for initial public offerings.

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Despite their distinct cultures, histories, and languages, the ten member states of ASEAN share a focus on jobs and prosperity. Household purchasing power is rising, transforming the region into the next frontier of consumer growth. Maintaining the current trajectory will require enormous investment in infrastructure and human-capital development—a challenge for any emerging region but a necessary step toward ASEAN's goal of becoming globally competitive in a wide range of industries. The ASEAN Economic Community offers an opportunity to create a seamless regional market and production base. If its implementation is successful, ASEAN could prove to be a case in which the whole actually does exceed the sum of its parts.

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[8] Based on data from Bank of America Merrill Lynch.