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Flash Notes

ASEAN: AEC and China the Key Drivers in Trade and Investment into the Next Decades

- The rise of China, coupled with the establishment of the ASEAN Economic Community (AEC) from 2015, is expected to provide new catalysts for growth in Southeast Asia, which we expect to be larger than that of the UK by 2020 and that of Japan by 2025.

- Domestic factors such as population growth and the rise in the middle income class in Southeast Asia will pave the way for AEC's promise of an integrated production platform and market size, as well as to tap into a region that is already outward-oriented in its trade and investment.

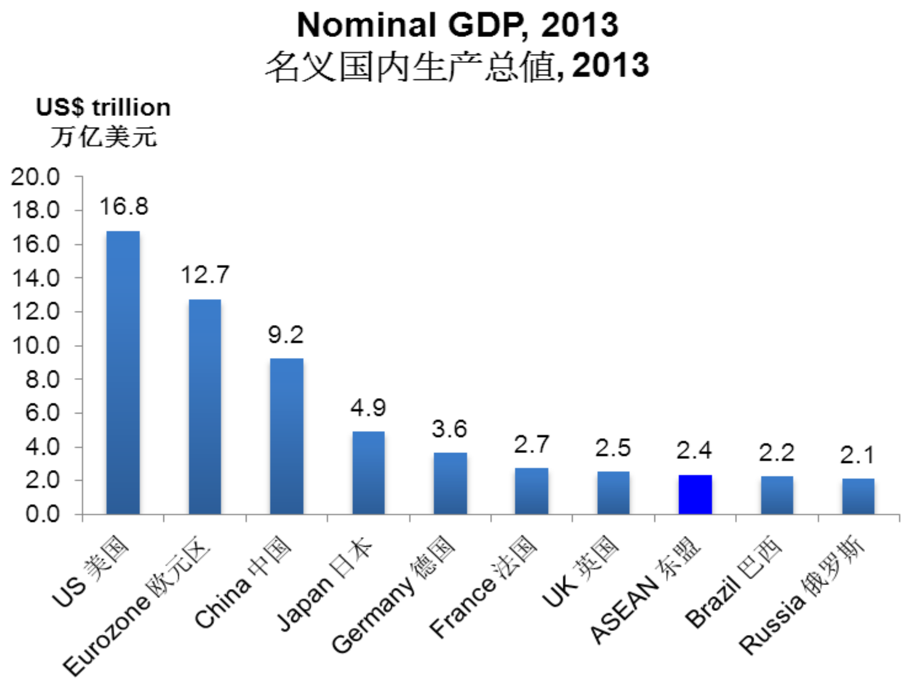
- The shift in domestic conditions in China is propelling further outward orientation, which will result in closer integration and relations with ASEAN through trade and investment channels.

AEC: A New Phase for Southeast Asia's Economy

The commencement of the AEC from end-2015 will usher in a new era of cooperation and business opportunities among the grouping's ten members. The AEC will play a crystallising role for the region as it aims to achieve the objectives of 1) a single market and production base; 2) a highly competitive economic region; 3) a region of equitable economic development; and 4) a region that is integrated fully into the global economy.

This integration project will bring to the table a unified economic platform with more than 600 million population and nominal GDP value of US$2.4 trillion in 2013, which accounts for a 3.1% share of global GDP of US$75 trillion. If ASEAN was a country, it would be the world's seventh largest economy, just ahead of Brazil, though lagging far behind the US (the world's largest) and the second largest, China (see chart below).

However, it should be noted that the AEC itself will not be a panacea the moment it is launched. Rather, the AEC is the beginning of a long process integrating and leveraging each country's strengths and guiding all the ten member states to move towards the objectives mentioned above. But at the same time, it is also clear to the member states that any other alternatives would be sub-optimal to the AEC solution, as productivity, competitiveness, market size, among others, will be key factors for member countries in an increasingly competitive environment with the rising economic powers like China and India, as well as other emerging economies which are also vying for a piece of the trade and investment pie.



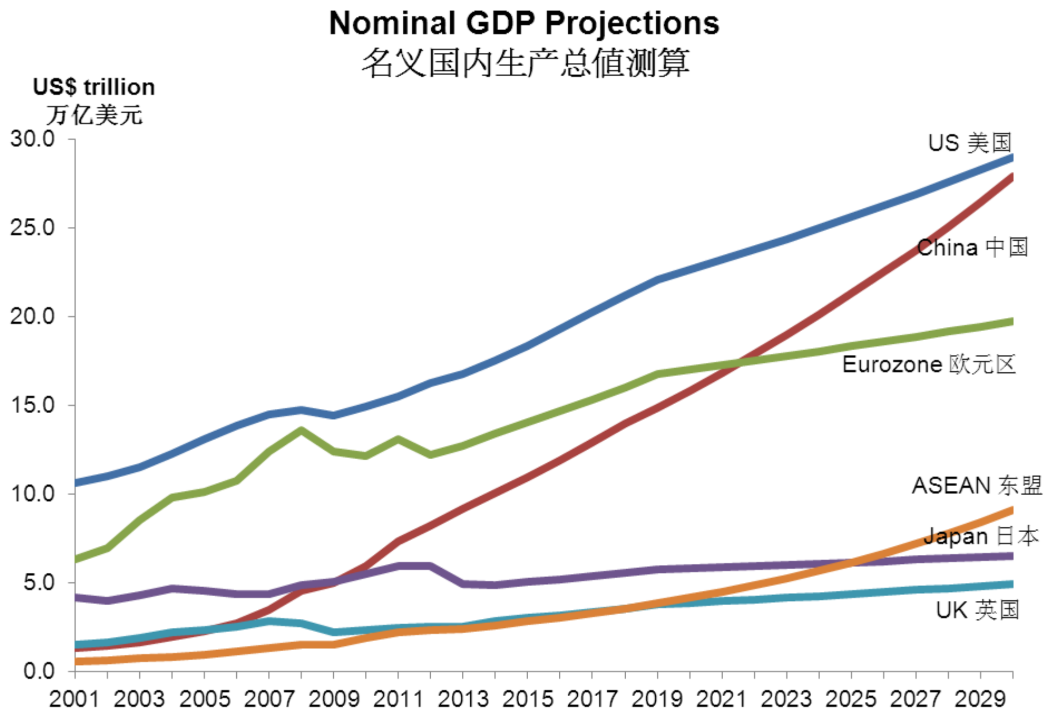
Source: World Bank and UOB Global Economics and Markets Research's estimates

Southeast Asia's Economic Size to Exceed Japan by 2025

In view of the dynamism and scale of an integrated region, our projections show that even by growing annually at just about two-third of the pace that it was used to during the period of 2001 to 2013, the size of the 10-member ASEAN's economy could exceed US$4 trillion by 2020 (roughly the size of Germany in 2013) and would be nearly four times larger by 2030 at US$9 trillion (size of China's economy in 2013).

This means that going by our calculations, along the way after 2020, Southeast Asia's economy would be larger than that of the UK and would overtake that of Japan by 2025. This would make Southeast Asia as one of the world's fastest-growing consumer markets as more enter the middle class status.

We anticipate that by 2030, China's economy would have expanded to US$28 trillion, just shy of the US economy's size of US$29 trillion, but would have exceeded Eurozone's economic size of about US$20 trillion (see chart below) by then.



Source: International Monetary Fund, World Bank and UOB Global Economics and Markets Research's estimates

We believe that these projections for Southeast Asia are achievable, going by recent developments in the region, including the opening up of Myanmar to the international community, presidential election in Indonesia and the return of stability in Thailand after the military coup that ousted former PM Yingluck among others. In addition, the less-developed members such as Myanmar, Cambodia, Laos and Vietnam have plenty of room for growth and to catch up given their low starting bases.

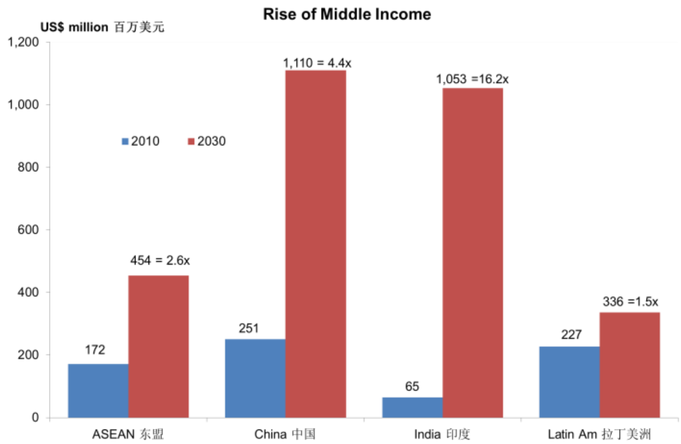
In addition, we expect that pro-business policies will continue to be pursued by various member states within ASEAN, especially within the guiding framework of AEC starting from 2015 that will help to promote free flow of goods, services, investment and skilled labour, as well as freer flow of capital, all of which would serve to make the region into an enlarged production base and a consumer market.

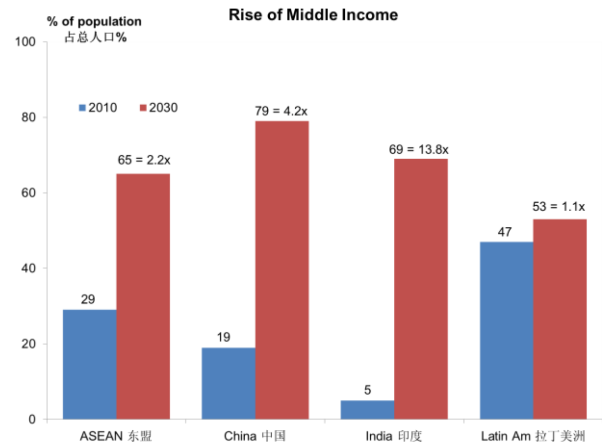
Driving Factors for Southeast Asia's Growth Story

Population

Having a large population of more than 600 million is clearly an advantage, especially within a fast- growing region, which would ensure rising income and standards of living, which will then spur rising consumer demand for a wide range of products and services.

Indeed, the Asian Development Bank estimated that by 2030, nearly half a billion of population in Southeast Asia will be classified as middle income class. This represents close to 65% of the population by then, from 29% of the Southeast Asian population in 2010 (see charts below).

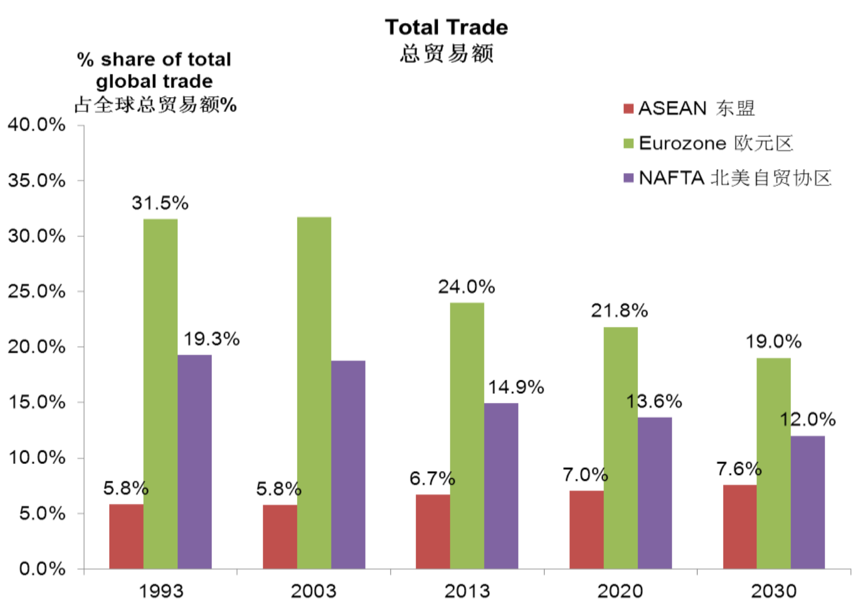




Middle income: daily expenditure of US$10-100
Source: ADB Institute

ASEAN itself is already a trade-driven bloc and we anticipate the momentum will continue in the decades ahead, given the rich store of resources and an established manufacturing base which will be boosted further by the AEC. This will the key to drive further both intra-ASEAN trade (among members of ASEAN), as well as extra-ASEAN trade (trade with countries outside ASEAN grouping) as the promises of a single production platform and a unified market strengthen trade activities.

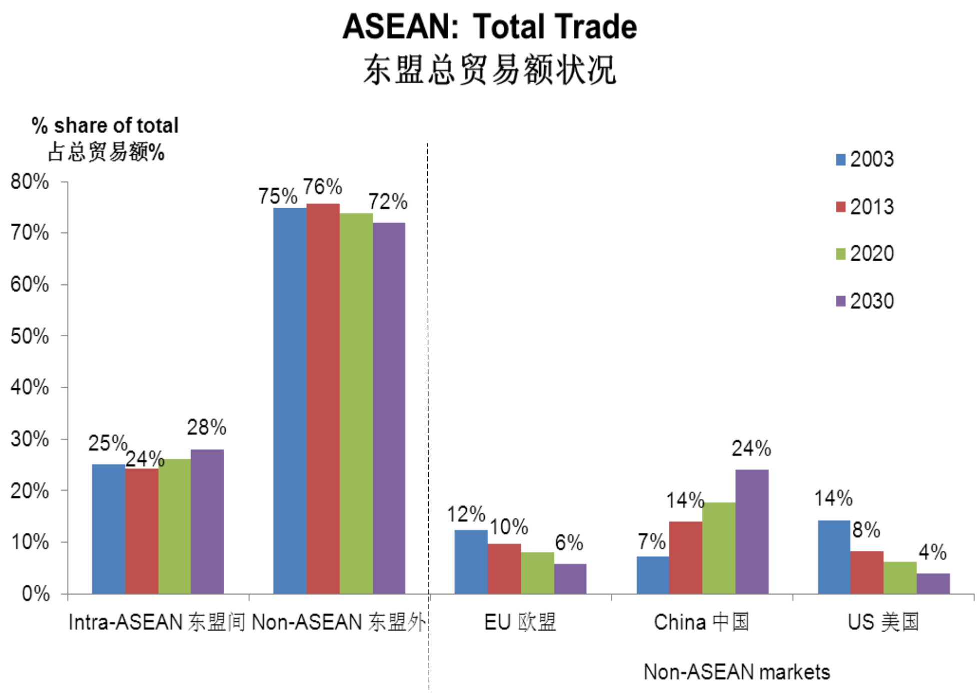
As shown in the chart below, share of ASEAN's total trade (exports plus imports) was at 5.8% of the world's total trade in 2003 and rose to 6.7% share in 2013, while the shares of the other major blocs such as the Eurozone and the North American Free Trade Area have been falling over the years. Assuming the same compound annual growth rates experienced in 2003 to 2013 for these trading blocs, we expect ASEAN's share to rise further to 7.6% by 2030 and for Eurozone and NAFTA to continue to fall.



Source: UNCTAD and UOB Global Economics and Markets Research's estimates

This is reflected in our forecasts for ASEAN's total trade which would see intra-ASEAN trade to rise from the current 25% share to 28% share of global trade by 2030. It should be noted that with closer trade relations with China, especially with the opening up of Myanmar, the share of China's total trade with ASEAN member states is expected to rise to 24% by 2030, more than three times the amount seen in 2003. Meanwhile, the shares for the US and Eurozone will decline further, continuing the downtrend seen between 2003 and 2013.

The view from ASEAN is even more optimistic, with the former ASEAN Secretary-General, Dr Surin Pitsuwan, was quoted as saying that with the movement of goods and services among ASEAN countries after the implementation of the AEC in 2015, he expects that intra-ASEAN trade will increase to 30% share and reach 35% five years later in 2020.



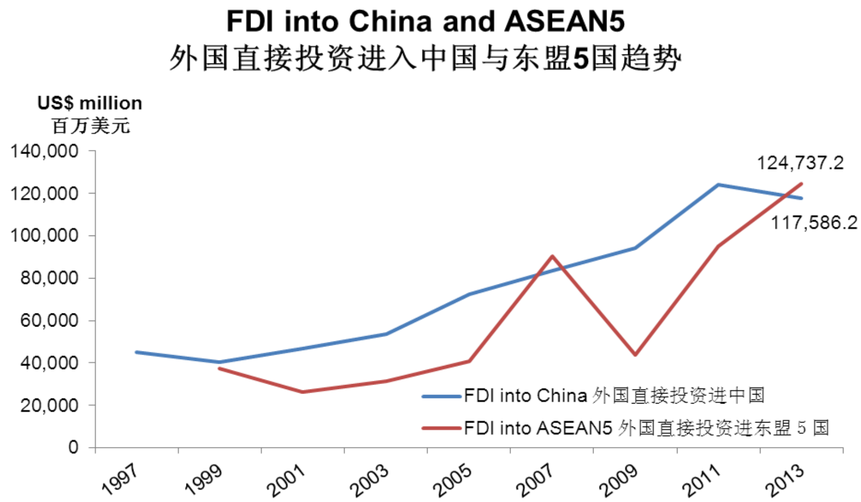
Source: ASEAN statistics and UOB Global Economics and Markets Research's estimates

Foreign Direct Investment (FDI)

The other key factor both as a stimulus at the early stages, as well as a force to sustain growth momentum in the subsequent stages, is the severe lack of infrastructure investment in the region. According to the Asian Development Bank, more than US$8 trillion of infrastructure investment will be required in Asia between 2010 and 2020 and over US$800 million of that for Southeast Asia.

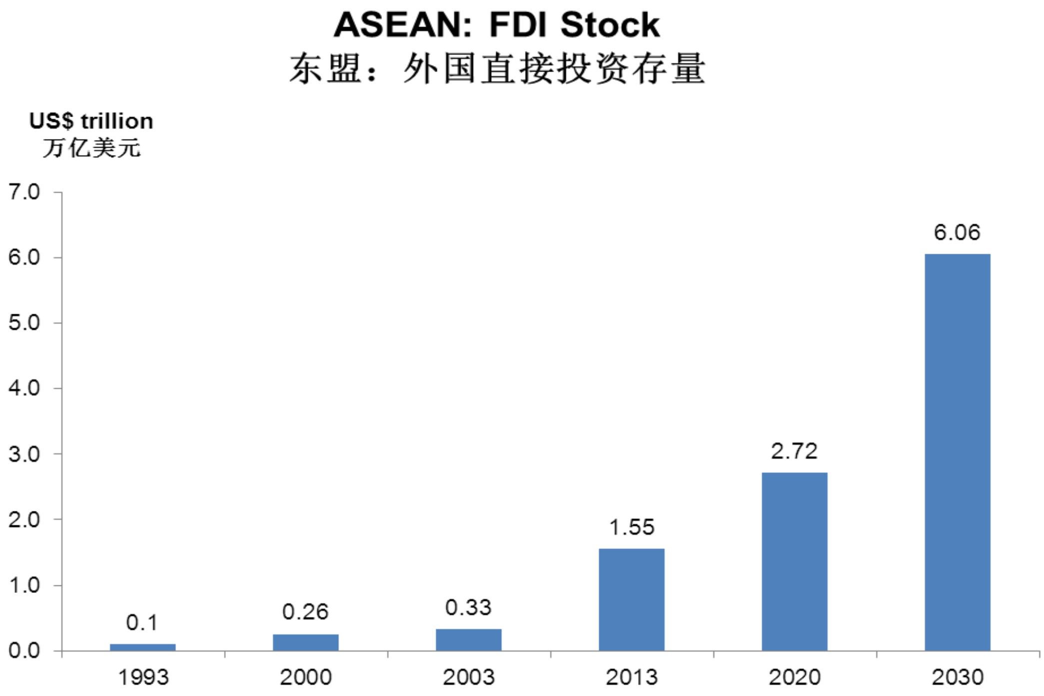
For example, one fact to underscore the lack of infrastructure investment in the region is that in China by 2020, investment in high speed rail is projected to reach US$300 billion (the equivalent of Malaysia's nominal GDP in 2013), with track length of 25,000km. In contrast, Southeast Asia's first high speed rail has barely gotten off the ground, with Malaysia and Singapore still in the planning phase of the 330km KL-Singapore line, with estimated cost of US$12 billion and slated for 2020 completion. Thailand is also reportedly going ahead with its high speed rail project for completion in 2021, which will eventually be part of the 3,000km Kunming-Singapore line that passes through Laos, Thailand and Malaysia.

The lag in infrastructure investment and the opening up of economies such as Myanmar have presented opportunities within Southeast Asia, attracting investors' attention with increased investment inflows. As shown in the chart below, Southeast Asia has surpassed China for the first time in terms of volumes of FDI inflows after falling behind for more than a decade (see chart below).



ASEAN5: Indonesia, Malaysia, Philippines, Singapore and Thailand
Source: CEIC and UOB Global Economics and Markets Research's estimates

We anticipate the FDI flows into Southeast Asia will continue to gather momentum. The stock of FDI accumulation in Southeast Asia has been rising at a steady pace of about 16% annualised rate since 1980. Even with a conservative assumption of about 8% annual growth (i.e. half the historic growth rate), the stock of investment in Southeast Asia is expected to nearly double to US$2.7 trillion in 2020 and to US$6 trillion by 2030, from US$1.6 trillion in 2013.



Source: UNCTAD and UOB Global Economics and Markets Research's estimates

The China Connection

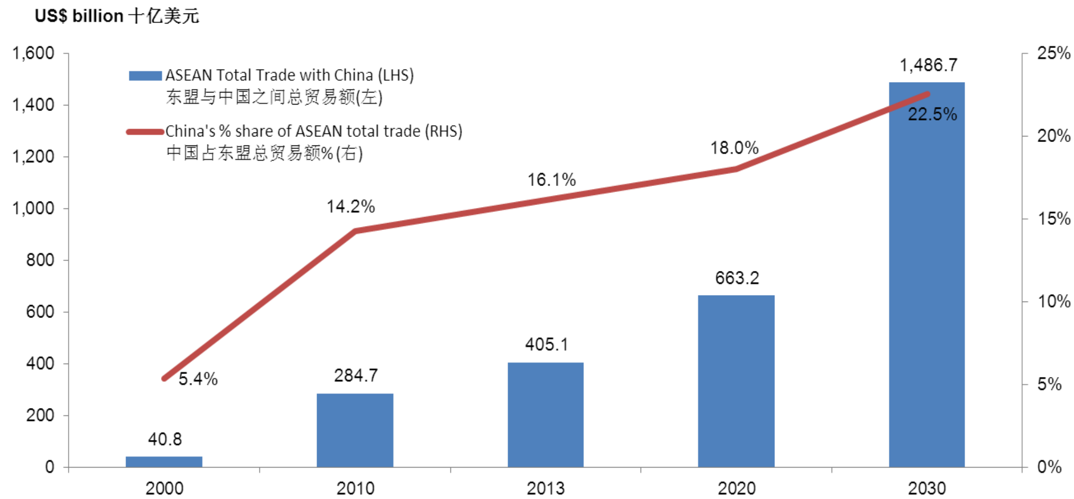
Amid all these optimistic projections for Southeast Asia as a result of AEC's crucial role in driving trade and investment into the region, the other main driving force will be that of China.

China has been playing an active role in building trade and investment relations with Southeast Asia in the past decade, extending the historic relationship that dates back thousands of years. In 2013, China's President Xi Jinping mooted the idea of the New Silk Road or the Maritime Silk Road that starts from Fujian province and linking all the littoral countries of the region.

From the perspective of trade and investment, this Maritime Silk Road concept will deepen further China's connection with Southeast Asia, with AEC serving as a main catalyst. As China faces its domestic "growing pains" of rising labour costs, land costs and appreciating currency, it is increasingly seeking new production and market bases and Southeast Asia will be the natural destination given the geographic and historic ties.

So far, China has been playing a rising role in Southeast Asia. As shown in the chart below, China's share of ASEAN's total trade has more than doubled from 5% in 2000 to 14% in 2010 and to 16% share or US$405 billion in 2013. Based on our projections, China's share (excluding Taiwan and Hong Kong) could reach 24% or US$1.5 trillion by 2030.

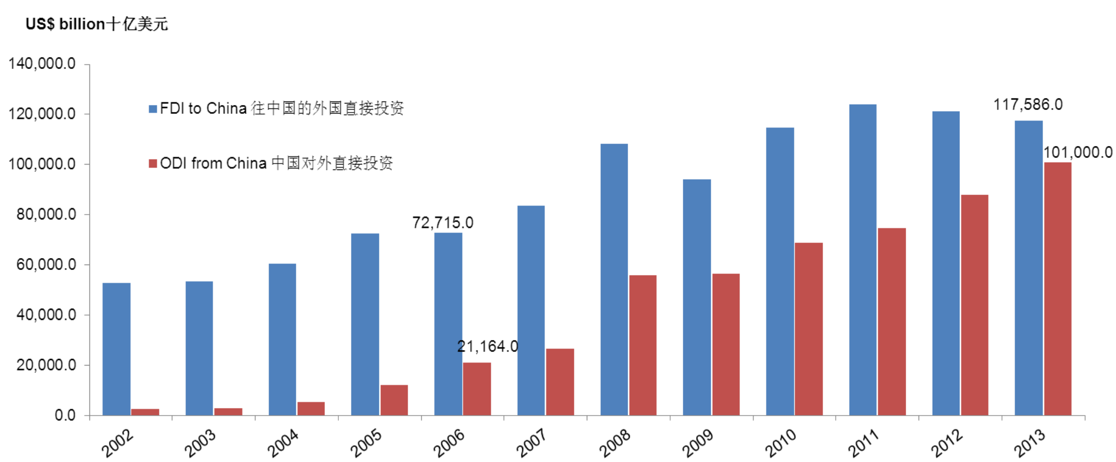
ASEAN: Total Trade with China
东盟-中国总贸易额



Source: CEIC and UOB Global Economics and Markets Research's estimates

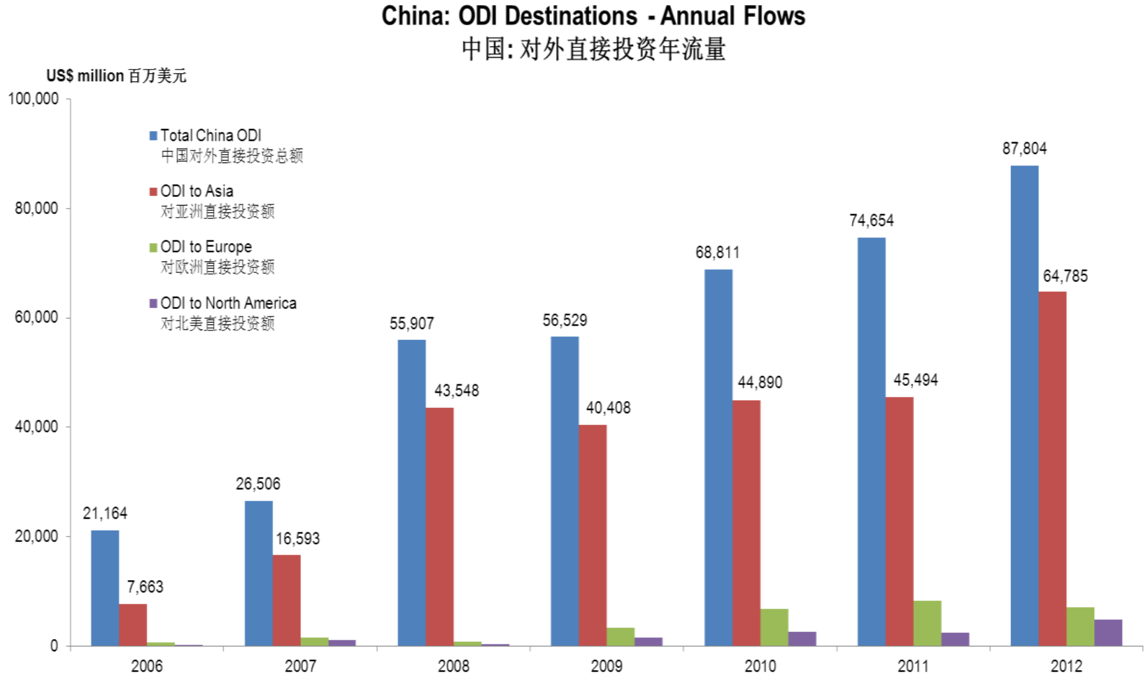
Similarly on the investment front, China's push on overseas investment in recent years (in order to balance out investment inflows and also to reduce partly appreciation pressure on the RMB), has seen Southeast Asia as a main beneficiary. This has resulted in both inflows and outflows of China's direct investment, closing the gap from what was the case 10 years ago.

China: FDI and ODI
中国:"引进来"、"走出去"



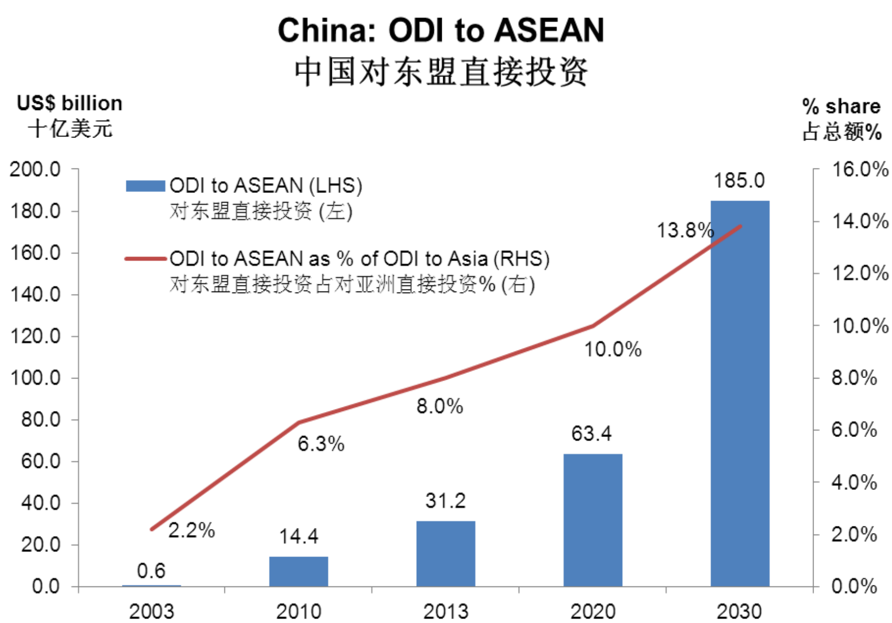
Source: CEIC and UOB Global Economics and Markets Research's estimates

As shown in the charts below, China's overseas direct investment (ODI) has accelerated since 2007 (see chart below). Of note is that Asia represents the bulk of China's annual ODI flow to the world, accounting for 73% share in 2012.



Source: CEIC and UOB Global Economics and Markets Research's estimates

In 2003, China's ODI to ASEAN countries was around US$600 million and accounted for only 2.2% of China's annual ODI flow to Asia and that figure has climbed to 8% by 2013. Based on our projections, the share could rise to 14% by 2030, with flow of US$185 billion or 6 times larger compared to 2013.



Source: CEIC and UOB Global Economics and Markets Research's estimates

Conclusion

The rise of China, coupled with the establishment AEC from 2015, is expected to provide new catalysts for growth in Southeast Asia. Even with the use of fairly conservative assumptions in our economic projections (i.e. in most of forecasts in this report, we assumed just half of the compounded growth rates seen in the previous period), the future of Southeast Asia is indeed promising. For instance, after 2020, Southeast Asia's economy would be larger than that of the UK, and would overtake that of Japan by 2025.

Domestic factors such as population growth and the rise in the middle income class in Southeast Asia will pave the way for AEC's promise of an integrated production platform and market size to leverage a region that is already outward-oriented in its trade and investment. This will see Southeast Asia's share of global total trade to rise from 6.7% in 2013 to nearly 8% by 2030, which is no small feat given that other major groups such as the Eurozone will be seeing a dwindling share of global trade.

At the same time, the shift in domestic conditions in China is propelling further outward orientation, which will result in closer integration and relations with Southeast Asia through trade and investment. These two channels could see Southeast Asia's total trade with China rising to US$1.5 trillion and investment inflows from China rising to US$185 billion, from US$405 billion and US$31 billion, respectively.