McKinsey&Company

ASEAN Insights:
Regional trends

November 2016

1. Global trends

GLOBAL ECONOMY GREW STEADILY ON HEALTHY MANUFACTURING AND SERVICES PERFORMANCE; IMPLICATIONS OF US PRESIDENTIAL ELECTION STILL BEING PROCESSED

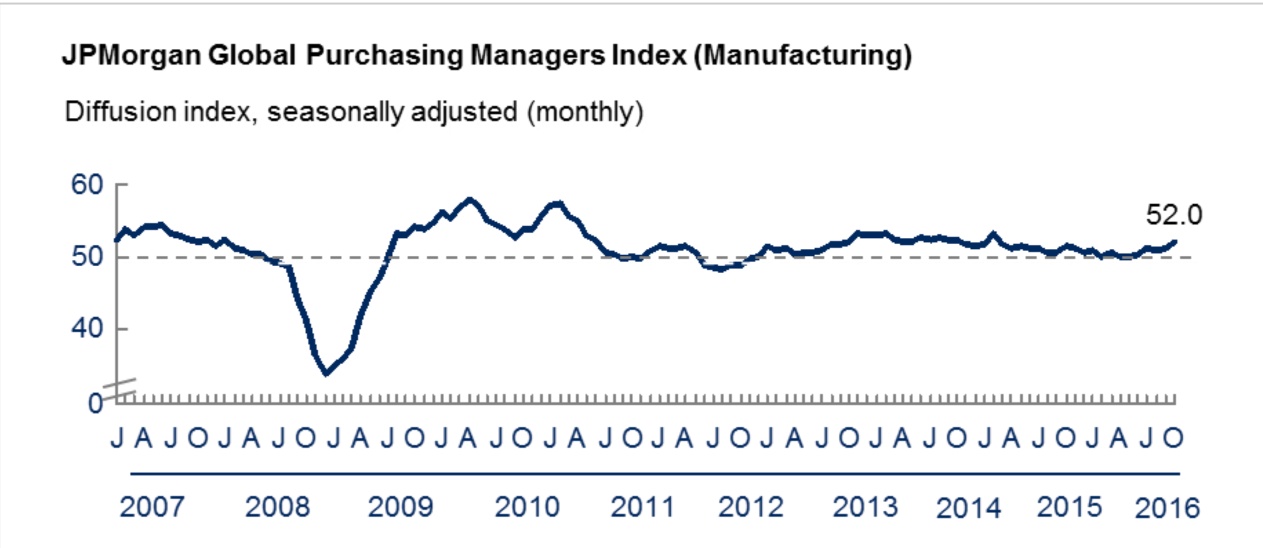
The global economy improved overall in the third quarter of 2016. GDP growth was 2.9 percent in the United States, the fastest quarterly rate since 2014. Eurozone growth held steady at 0.3 percent, with improvement in France and Italy but a slight slowdown in Germany. In emerging markets, China grew 6.7 percent for the third quarter in a row; meanwhile in India—where 2016–17 expansion was 7.6 percent—robust growth is expected, but at a somewhat slower pace due to demonetization of large rupee notes.

In October and November, global consumer confidence rose and the manufacturing and service-sector activity remained in expansion territory, increasing again this month. The global manufacturing PMI rose one point in October, to 52.0 (from 51.0 in September), with solid expansion in output and new orders. The growth was broadly driven, with expansion in both developing and emerging markets. The global services PMI also expanded, to 53.2 (from 51.6 in September), with the United States being the main contributor.

The economic environment has become somewhat more inflationary, but not uniformly so. Consumer and producer price inflation accelerated in developed economies, but not uniformly across developing economies. There has been an upward movement in the prices of some commodities, led by a 7 percent rise in industrial metals prices. Oil price, which had reached US$53 in early October, fell back to US$46 in mid-November and supplies continue to be very high despite OPEC's intention to cut production. Equity-market volatility spiked in advance of the US elections, but has since relaxed. However, some volatility indices have been rising including oil and currencies.

The policy implications and potential economic effects of the US Presidential Elections are still being processed. Some expansionary expectations have been expressed in US equity markets, although the impact on the real economy is still unclear as policies remain undecided. Federal Reserve Chair Janet Yellen, a Democrat, made clear to Congress on 17 November that she will serve out her term ending January 2018.

Global manufacturing activity increased in October, with the PMI rising to 52.0 from 51.0 in the previous month

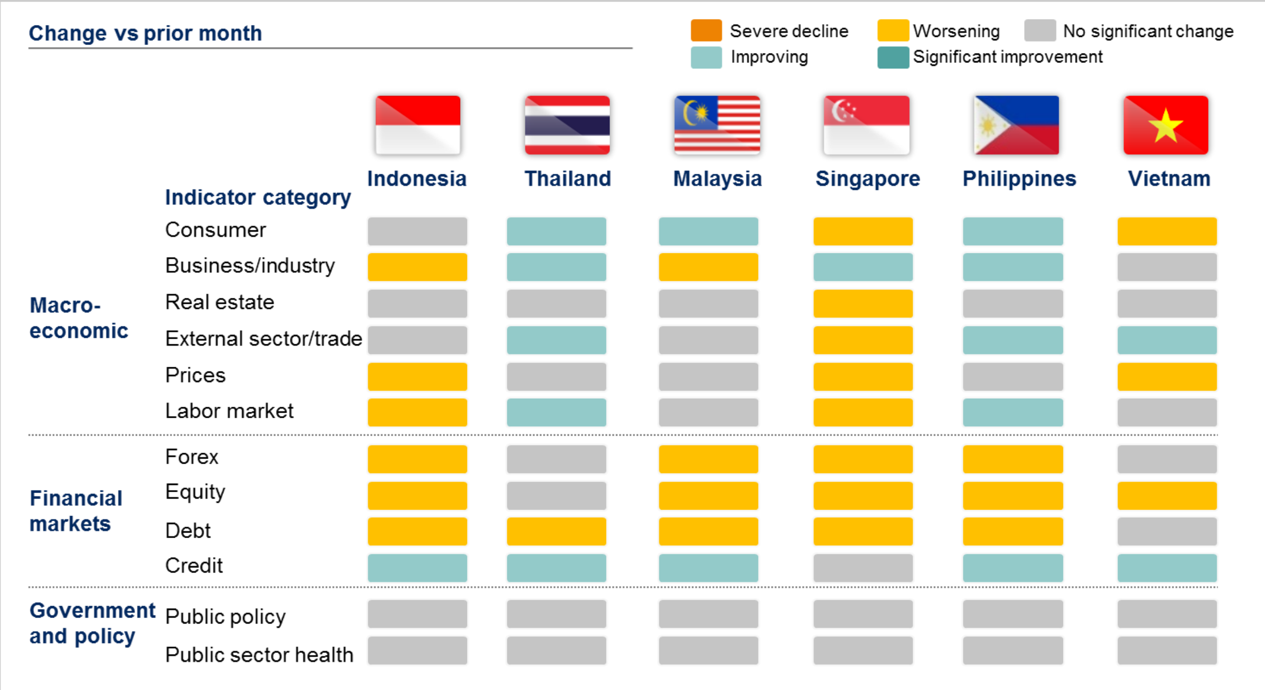


SOURCE: JP Morgan, McKinsey Global Economics Intelligence Analysis

2. Regional trends: ASEAN

MIXED GDP RESULTS ACROSS THE REGION; US PRESIDENTIAL ELECTION NEGATIVELY AFFECTED REGIONAL MARKETS

Trade volumes picked up across the region but economic performances remained generally mixed



Overall economic performance was mixed in October. Trends were largely country specific, although trade volumes and inflation across the region rose. Third-quarter GDP results were also released, with mixed performances across the region. Expansion in the Philippines, Vietnam, and Malaysia accelerated, but slowed in Indonesia, Thailand and Singapore.

Macroeconomic trends

Country-level performance was uneven.

Third-quarter GDP results were released this month with mixed performance trends across the region. Growth in the Philippines, Vietnam, and Malaysia accelerated: year-on-year growth was 7.1 percent versus 7.0 percent, 6.4 percent versus 5.8 percent, and 4.3 percent versus 4.0 percent respectively. However, in Indonesia, Thailand, and Singapore it eased: year-on-year growth was 5.0 percent versus 5.2 percent, 3.2 percent versus 3.5 percent, and 1.1 percent versus 2.0 percent respectively. Growth was mostly led by increases in private consumption while both exports and imports generally increasing despite government spending eased.

Leading and current indicators were also mixed this month. Business and consumer conditions improved for Thailand and Philippines but either remained constant or deteriorated for other countries. Nonetheless, trade volumes generally improved across the region, with the exception of Singapore, which has been facing structurally lower trade volumes. Prices also continued to climb across the region.

Financial markets

ASEAN financial markets reacted negatively to the outcome of the 2016 US Presidential Election. Severe capital outflows were witnessed across the region, causing bond yields to spike, equity markets to drop, and local currencies to depreciate relative to the US dollar with Indonesia, Malaysia, and the Philippines particularly affected.

Government policy

In Malaysia, the central bank held its benchmark interest rate at 3 percent. The depreciation of the ringgit in the immediate aftermath of the US Presidential Election also prompted an unusual move to temporarily restrict the selling of ringgit for dollars.

SOURCE: McKinsey Global Economics Intelligence Analysis

3. ASEAN Insights: Country analysis

THE REGION AT A GLANCE

THAILAND

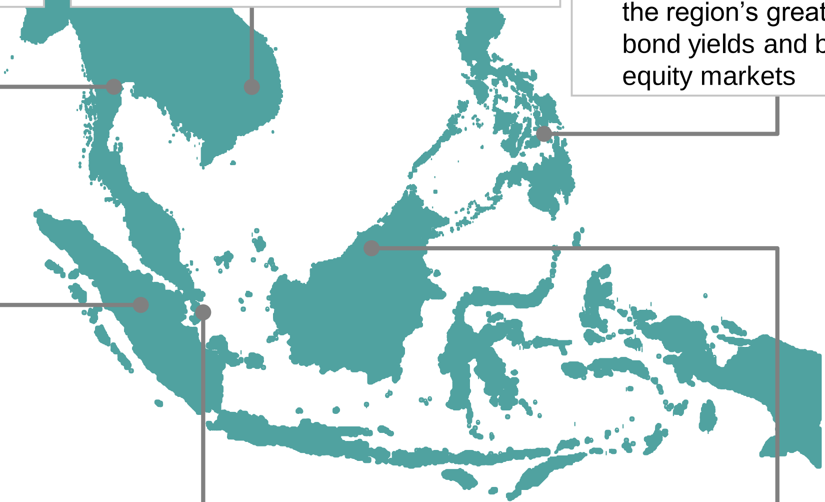
- **Third-quarter GDP results disappoint** (3.2% vs previous 3.5%, expected 3.4%) as investments and government spending slowed
- **Current indicators were more positive** as retail sales, industrial production and exports continued to exceed expectations for the second month in a row
- **Financial markets were not as badly affected as the other ASEAN countries** in the aftermath of the US Presidential election

VIETNAM

- **Third-quarter GDP results were positive**. The economy grew at 6.4% compared with the previous quarter's 5.8%. The expansion was boosted by rising exports and recovery from adverse weather conditions
- **Retail sales slowed unexpectedly** to grow 1.3% year-on-year in October from 15.6% in September, while also contracting on a monthly basis
- **Inflation continued to rise**, spiking to 4.1% in October—the highest inflation rate since August 2014

PHILIPPINES

- **The Philippines economy expanded by 7.1% in Q3 2016**, the fastest rate since Q2 2013, mainly supported by strong private consumption
- **Leading indicators for the month were generally positive** with acceleration in retail sales, industrial production, exports, and imports
- **However, capital markets were seriously affected by the US Presidential election** with the country experiencing the region's greatest rise in bond yields and biggest fall in equity markets



INDONESIA

- **Conditions appear to be moderating**
- **Third-quarter GDP results were in-line with expectations,** with the economy expanding by 5.02%, compared with an upwardly revised 5.19% growth figure in the previous quarter
- **Industrial production slowed surprisingly**, growing at 0.53% year-on-year (vs 6.13% previously), while contracting on a month-on-month basis
- **Unemployment rates also rose to 5.61% in Q3 2016**, up from 5.50% in the previous quarter

SINGAPORE

- **Indicators continue to suggest challenging conditions in the short term**
- **Third-quarter GDP results were poor**. The economy expanded at 0.6%, its weakest growth rate since 2009
- **Retail sales unexpectedly contracted** by -1.0% year-on-year vs +2.7% rise in the previous month
- **However, there are silver linings as industrial production was unexpectedly strong**, expanding by 6.7% year-on-year vs 0.5% in the previous month

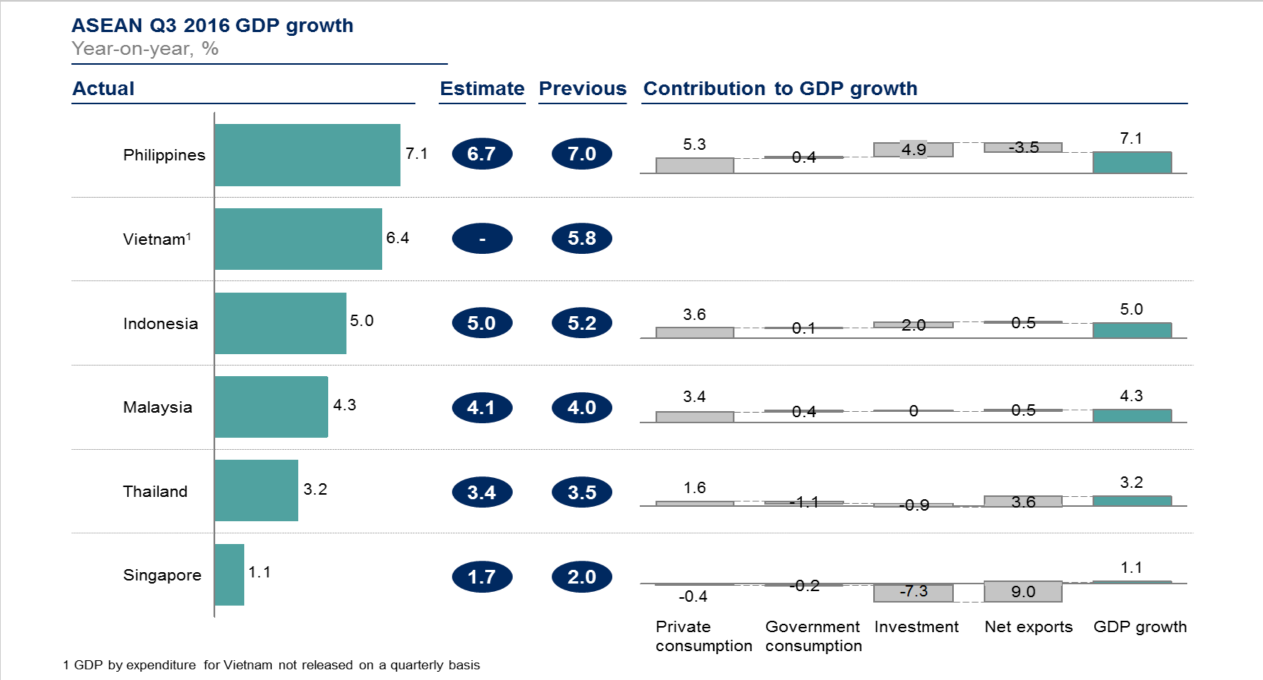
MALAYSIA

- **Third-quarter GDP results exceeded expectations** with the economy expanding by 4.3% year-on-year as faster increases in private consumption offset a decline in government spending and investment
- **However, current indicators for the month disappointed**
- **Industrial production growth slowed** to 3.2% year-on-year (previously 5.1%), while **the PMI slid further into contractionary territory** to 47.2 (previously 48.6)
- **Both exports and imports also continued to record year-on-year declines**

SOURCE: McKinsey Global Economics Intelligence Analysis

Q3 2016 GDP RESULTS: MIXED PERFORMANCES ACROSS ASEAN ECONOMIES

Despite the region's mixed results, as a whole the region witnessed faster increases in private consumption and export contributions



Philippines: Regional outperformer driven by twin engines of consumption and investment; exports also recover

Both public and private sector investments grew strongly (16 percent and 20 percent respectively), while consumer conditions continued to be supported by low inflation and a tighter labor market. Export contributions also increased both on a year-on-year and month-on-month basis.

Vietnam: Growth led by recovery in agriculture and rising exports

The economy expanded by 6.4 percent, recovering from two previous quarters of relatively slow growth (Q2: 5.8 percent, Q1: 5.5 percent) as adverse weather dissipated to boost agricultural outputs, and manufacturing exports continued to grow strongly.

Indonesia: Private consumption remains main driver; government spending slows

Q3 saw slower but expected growth rates. While the economy does appear to be moderating—as seen in weaker export, government, and investment contributions—private consumption remained strong.

Malaysia: Strong headline growth number slightly misleading

Concerns remain despite the headline growth number surpassing expectations. While private consumption grew strongly, export contributions were fueled by a contraction in imports as opposed to an expansion of exports (exports: -1.3 percent year-on-year; imports: -2.3 percent year-on-year). Investment growth and government consumption also decelerated sharply, partly due to oil-related budget rationalization.

Thailand: Expansion slows but exports show recovery

Investments continued to contract while private consumption is expected to slow further, but exports showed a strong recovery to record its first year-on-year expansion in seven quarters

Singapore: Weakest growth since global financial crisis

Challenging conditions continue with the economy contracting by -2.0 percent on a seasonally-adjusted quarterly basis, led by contractions in the manufacturing and services sectors. On an annual basis, this is the weakest growth rate since Q2 2009, amidst the global financial crisis.

SOURCE: CEIC, McKinsey Global Economics Intelligence Analysis

Indonesia

THIRD-QUARTER GDP RESULTS MEET EXPECTATIONS; CONDITIONS MODERATE THIS MONTH; RUPIAH DEPRECIATES

Indonesia's growth trajectory appears to be moderating slightly after positive developments in the first half of the year.

Third-quarter GDP results indicate that the Indonesian economy expanded by 5.02 percent year-on-year, which although slower than the previous quarter remained in-line with government and consensus estimates. Growth was driven by strong private consumption, offsetting a decline in government spending and net exports.

However, consumption indicators appear to be moderating as retail sales growth, while still healthy, slowed to increase 6.5 percent year-on-year in September versus 11.4 percent growth in August.

Industrial production also moderated with a surprise month-on-month contraction in September. On a year-on-year basis, industrial production grew by 0.53 percent, slowing from 6.13 percent in the previous month.

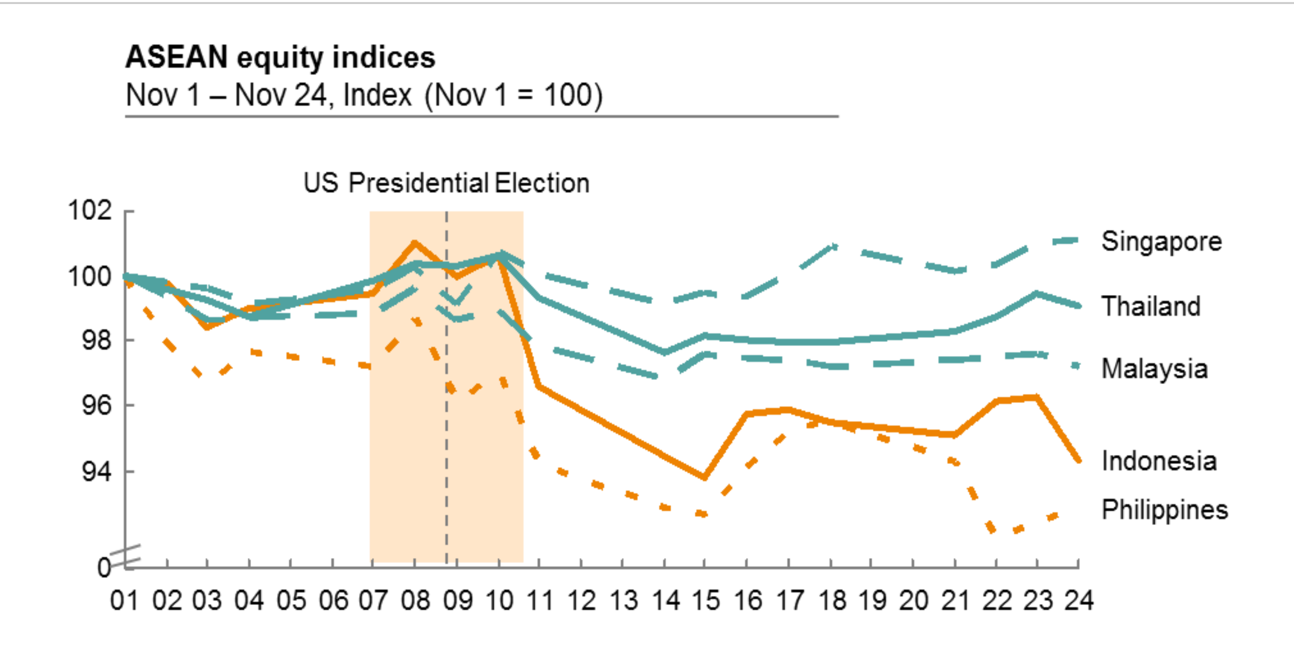
Indonesia's manufacturing PMI also dropped to contractionary territory to 48.7 in October from 50.9 in September. It was the first decline in three months, as output, new orders, and employment declined.

Worryingly, unemployment increased in the third quarter of 2016. The unemployment rate rose to 5.61 percent from last quarter's 5.50 percent.

Surprisingly, inflation continued edging upwards, reaching 3.31 percent year-on-year in October versus 3.07 percent the previous month—its highest level since June.

For external developments, the US Presidential Election rattled Indonesian capital markets. The rupiah fell to multiyear lows against the US dollar, while equity markets fell by 5.3 percent, making this the second worst-performing ASEAN market at the time of writing.

Indonesian equity markets, along with that of the Philippines, were negatively impacted by the outcome of the US Presidential Election



SOURCE: CEIC, McKinsey Global Economics Intelligence Analysis

Thailand

RECOVERING EXPORTS; THIRD-QUARTER GDP RESULTS DISAPPOINT BUT SILVER LININGS ON HORIZON

Thailand's external environment is beginning to show signs of recovery although domestic conditions still remain relatively weak.

2016 third-quarter GDP results were disappointing but silver linings remain apparent. The economy expanded at an annual rate of 3.2 percent, compared with 3.5 percent the previous quarter and below market expectations of 3.4 percent. The headline disappointment was due to a slowdown in domestic demand, where private consumption and investments contracted on a quarterly basis. However, exports continue to show positive signs, accelerating to grow at an annualized rate of 3.6 percent in Q3, up from 2.0 percent in Q2—but this was not enough to offset depressed domestic conditions.

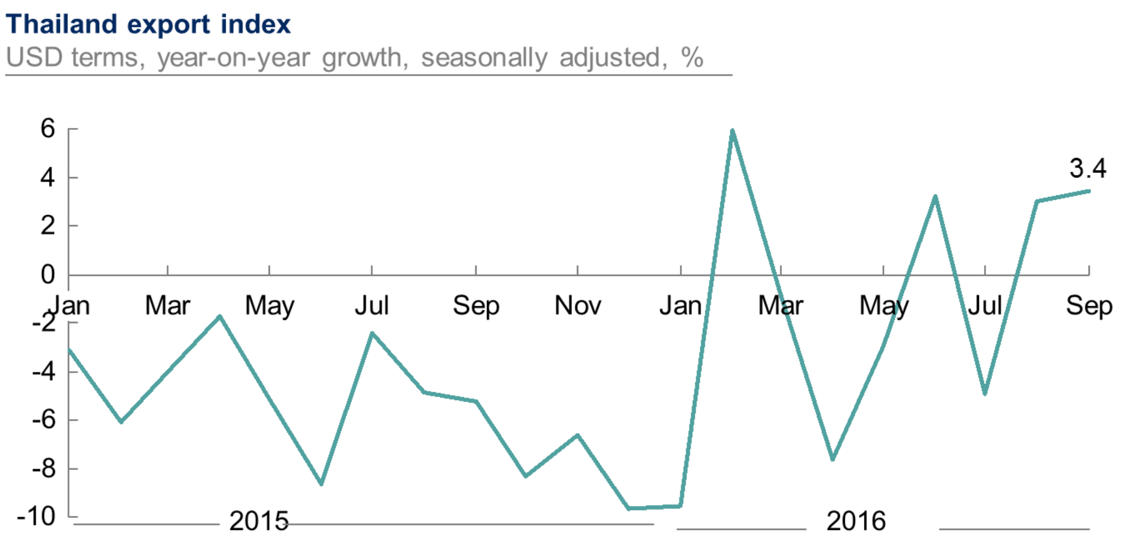
In terms of leading indicators for the month, Thailand experienced continued acceleration in retail sales, industrial production, and exports.

Retail sales growth accelerated to 5.6 percent in August from 2.2 percent the previous month, as sales in non-durable goods remained resilient while durable goods recovered from a contraction the previous month. However, next month's figures are likely to be muted given that it will be the first month of coverage following the passing of King Bhumibol.

Industrial production also beat expectations, posting 0.6 percent growth ahead of market consensus for a 0.3 percent drop. It was the second consecutive month of expansion supported by stronger demand for electrical goods. On a similar trend, both exports and imports also increased.

In other developments, the US Presidential Election had a surprisingly muted effect on Thailand compared with the region as a whole. Thailand's foreign exchange, equity, and bond markets were among the least affected of ASEAN countries.

Exports in September grew by 3.4 percent annually, the first time two straight months of year-on-year growth were recorded since October 2014



SOURCE: CEIC, McKinsey Global Economics Intelligence Analysis

Malaysia

THIRD-QUARTER GDP RESULTS SURPRISING BUT CONCERNS REMAIN; RINGGIT TUMBLES

Economic conditions moderated slightly as the country continues to struggle to generate a sustained recovery.

Q3 GDP results were a positive surprise but underlying concerns remain beyond the headline number. The economy expanded by 4.3 percent, faster than last quarter's 4.0 percent and beating expectations of 4.1 percent. Growth was supported by faster increases in private consumption. Worryingly however, was the slowdown in both investments and government consumption. Net exports contribution was also primarily due to declining imports as opposed to expanding exports.

Current indicators for the month remain largely unchanged with mixed signals throughout.

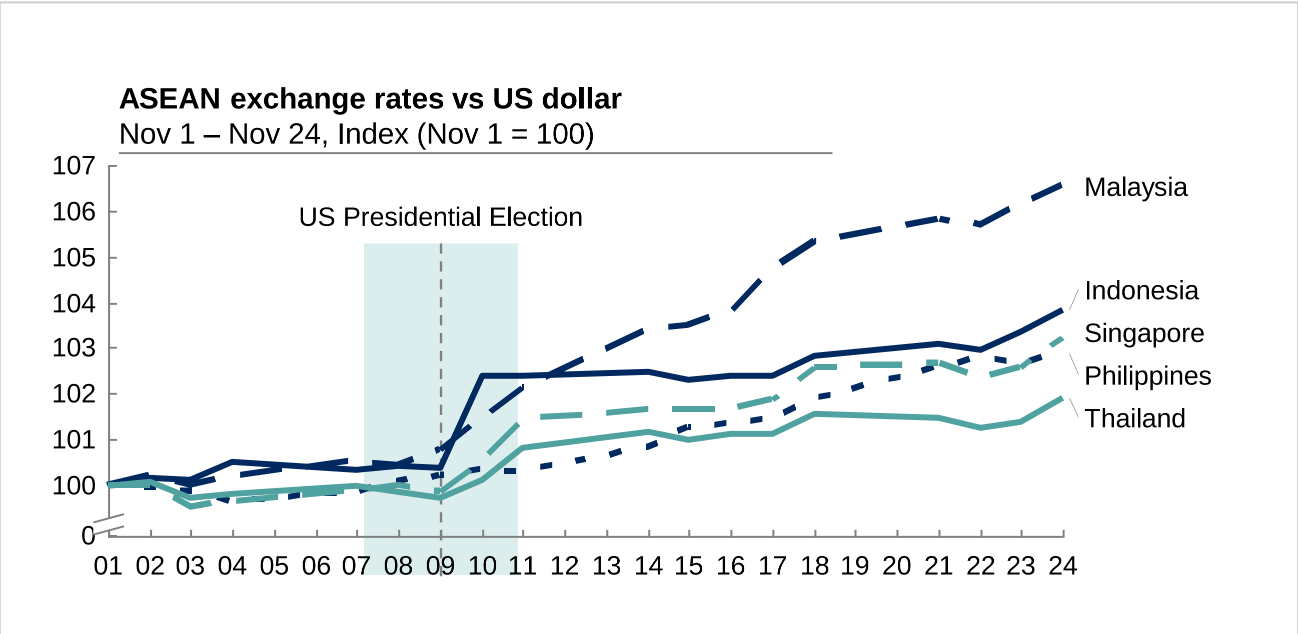
Production indicators moderated. The manufacturing PMI slid further into contractionary territory to 47.2 in October from 48.6 in September. Industrial production growth also slowed to 3.2 percent annually in September from 5.1 percent the previous month.

While conditions on the business side slipped, consumer indicators remain healthy. Retail sales growth accelerated to 9.2 percent in September from an upwardly revised 8.5 percent in August—the fastest growth rate since June.

Employment conditions also marginally improved. Although the unemployment rate remained steady this quarter at 3.5 percent, labor force participation increased, signaling greater optimism as the population strives to rejoin the workforce.

For external developments, the Malaysian ringgit depreciated heavily in the aftermath of the US Presidential Election, prompting intervention by the central bank which temporarily restricted selling of the ringgit for dollars. Despite this intervention, the Malaysian ringgit has lost 6.6 percent against the US dollar at the time of writing. Both equity and bond markets also took a tumble as capital outflows were observed across the region.

The Malaysian ringgit depreciated 6.6 percent against the US dollar in the aftermath of the US Presidential elections, becoming the worst-performing currency in the region



SOURCE: CEIC, McKinsey Global Economics Intelligence Analysis

Philippines

ECONOMY GROWS BY 7.1 PERCENT IN THIRD QUARTER; POSITIVE MOMENTUM MAINTAINED

The Philippines continued to post the region's fastest rate of growth with leading indicators also suggesting positive developments.

Third-quarter GDP results were highly encouraging. The economy grew at an annualized rate of 7.1 percent, accelerating from 7.0 percent in the previous quarter and above the market consensus of 6.7 percent. This is the region's fastest rate of growth and has prompted upward revisions of the country's full-year growth forecasts. Growth was supported mainly by strong private consumption, while the contribution from net exports eased as import growth remained strong, offsetting export growth.

Leading indicators also remain positive.

Production indicators suggest highly expansionary conditions, with the manufacturing PMI spiking to 57.5 in September from 55.3 in August. Industrial production growth also accelerated to 8.4 percent in August from 5.6 percent the previous month, the fastest growth since January.

Consumer conditions maintained their positive momentum. Retail sales growth accelerated marginally to 3.0 percent in September from 2.3 percent in August, while consumer confidence in the third quarter reached a high for the year to date at +2.5.

Trade indicators also improved. Exports grew by +5.1 percent in September following a -3.0 percent fall in August. This was the first month of year-on-year expansion since March 2015, driven by increased sales of electronic products (top export commodity, +66.3 percent), mineral products (+97.5 percent), and metal components (+18.2 percent).

Growth of the Filipino economy continued to accelerate for the seventh consecutive quarter

SOURCE: CEIC, McKinsey Global Economics Intelligence Analysis

 Singapore

THIRD-QUARTER GDP RESULTS INDICATE SLOWEST GROWTH SINCE 2009

Economic conditions in Singapore remain challenging, albeit with some bright spots in the manufacturing sector.

Third-quarter GDP results were poor. The economy expanded at an annualized rate of 1.1 percent, its weakest rate of growth since 2009. The service sector remained flat, while manufacturing expanded by 1.3 percent and construction growth slowed to 1.6 percent from 2.0 percent growth in the previous quarter.

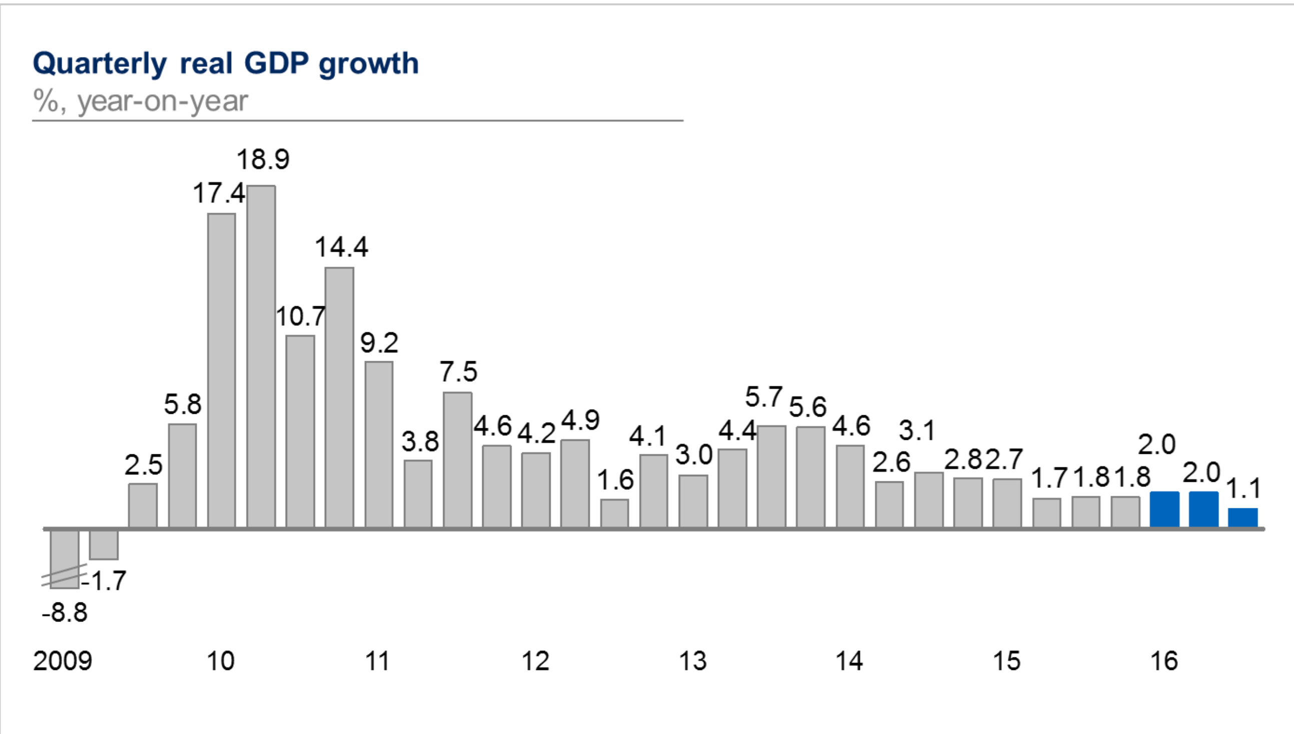
The manufacturing sector continued to show signs of bottoming out. Industrial production in Singapore rose 6.7 percent year-on-year in September, following a 0.5 percent increase in August, beating market estimates of a 0.6 percent gain. It was the second consecutive month of growth and the fastest since March 2014, as output rose for most categories: the biggest increases were in biomedical manufacturing (+22.2 percent) and electronics (+15.9 percent). The manufacturing PMI also remained at the threshold expansion level of 50.0 in October, although this was a slight drop from the previous month's reading of 50.1.

However, conditions are less positive in other parts of the economy. Retail sales recorded a surprise -1.0 percent year-on-year contraction in August versus a 2.7 percent rise in July. Sales fell for all consumer categories, with the exception of motor vehicles—the only category to grow—albeit at a slower pace.

Trade conditions also continued to deteriorate. Export and import volumes contracted, both on a month-on-month and a year-on-year basis.

Price pressures remain relatively weak though not as weak as previous months. Inflation was recorded at -0.1 percent in October, compared with -0.2 percent in September, as the cost of housing, utilities, and transport declined at a slower rate. Core inflation, which excludes volatile components such as housing and transport, rose to 1.1 percent from 0.9 percent in the previous month—its highest figure since June.

The third quarter of 2016 saw the economy expanding at its slowest rate since 2009



SOURCE: CEIC, McKinsey Global Economics Intelligence Analysis

Vietnam

ECONOMY REMAINS HIGHLY EXPANSIONARY; INFLATION CONTINUES TO RISE

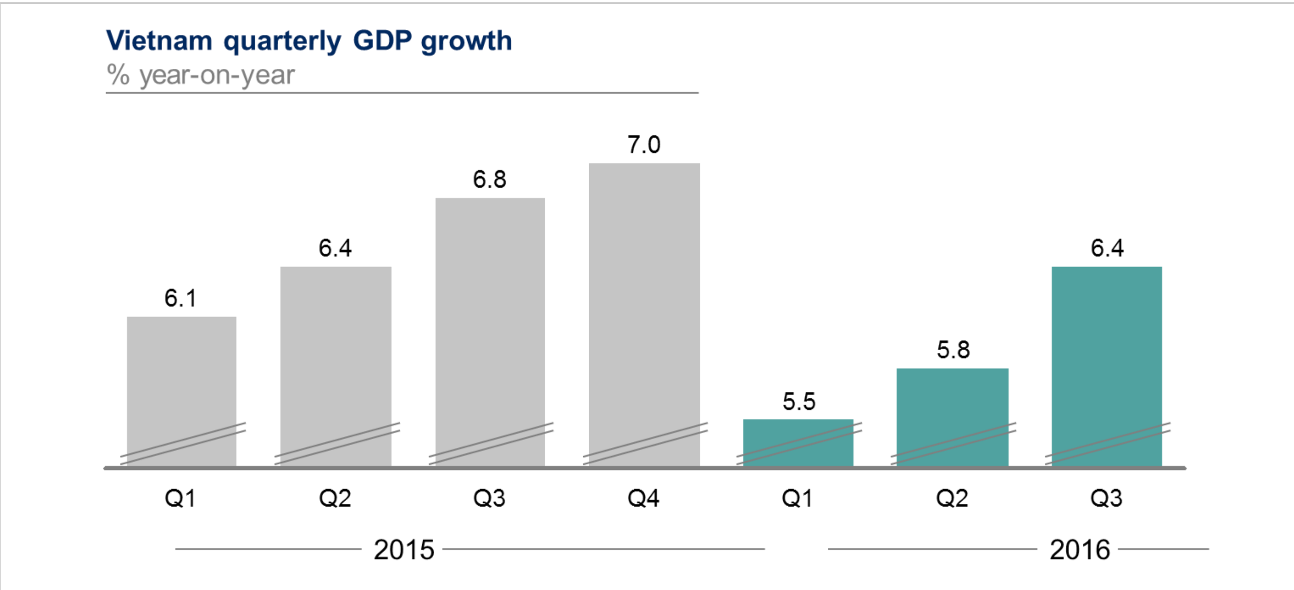
The Vietnamese economy remains one of the strongest in the region.

Third-quarter GDP results shows the Vietnamese economy expanding by 6.4 percent, compared with an upwardly revised 5.8 percent in the previous quarter. Rising exports and recovery from adverse weather boosted growth. This was the fastest pace of expansion this year but remains unlikely that the country will meet its full-year target rate of 6.7 percent due to lower growth in previous quarters.

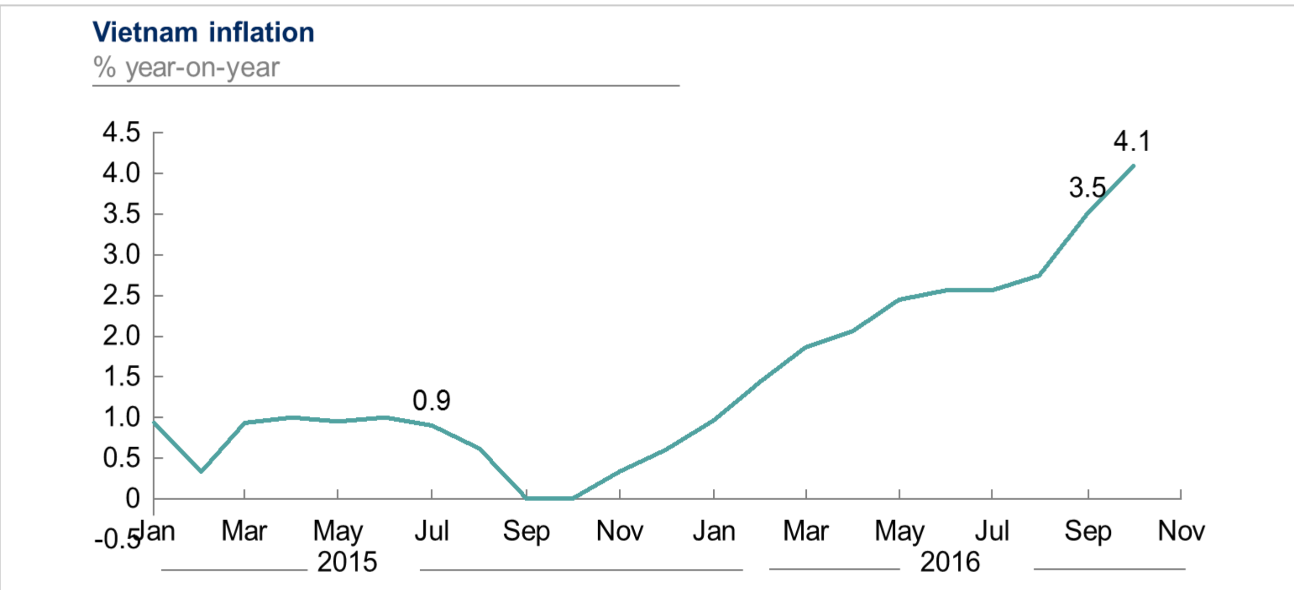
Leading indicators were surprisingly mixed for the month. Retail sales slowed unexpectedly to 1.3 percent in October from 15.6 percent in September. On a month-on-month basis, retail sales contracted to -2.4 percent from their previous +2.5 percent. Industrial production growth also slowed slightly to 7.0 percent in October from 7.6 percent in September.

However, price pressures continue to build. Inflation, no longer benign, carried on climbing in October to 4.1 percent versus 3.3 percent in September.

Vietnam's third-quarter GDP results puts it at the fastest pace of expansion this year



Price pressures continue to climb with inflation at its highest level in two years



SOURCE: CEIC, McKinsey Global Economics Intelligence Analysis

McKinsey & Company
November 2016

McKinsey_ASEAN_Insights@mckinsey.com
@McKinseyASEAN