30 June 2016

HSBC Global Research

ASEAN Perspectives

Politics to set the tone

ECONOMICS
ASEAN

- The impact of the UK referendum poses downside risks to growth in Europe, which could impact ASEAN exports
- Vietnam and Singapore are most exposed to trade with the EU and UK, but the Philippines and Indonesia are more insulated
- In this edition of ASEAN Perspectives, we focus on key political trends within the region; turn to page 3 for the feature article

ASEAN economies were not spared from the global impact of the Brexit referendum. The event increased volatility across asset markets, and it presents risks of slower global growth stemming from weaker investment conditions in Europe. Although the region's direct exposure to the UK is small, we estimate that Vietnam, Singapore, Thailand and Malaysia will be most impacted given their relatively high trade exposure to Europe as a whole. Note that HSBC's European economists have cut their 2017 EU growth outlook by half a percentage point, to 1.0% (from 1.5%), below their 2016 growth outlook of 1.4%.

Still, it is important to keep the overall impact in perspective. Within ASEAN, for example, Indonesia and the Philippines should be able to ride out comfortably any impact from Brexit. After all, growth remains domestically driven, and sentiment is improving. This week in Indonesia, the legislature passed the long-awaited tax amnesty bill, which should provide more fiscal room for the government. In the Philippines, President Duterte – who will be inaugurated today (30 June) – has assembled a high-calibre economic team that looks set to maintain and build on the economic policy priorities of his predecessor.

For the rest of the region, the outlook is a little more challenging. As we mentioned in our previous ASEAN Perspectives, in Thailand, Malaysia, and Singapore, growth held up well in 1Q, but the overall trend is set to weaken in the coming quarters given renewed global headwinds. While Vietnam will remain one of the region's stronger performers this year, 2Q GDP data revealed that growth continues to slow markedly compared with 2015, due partly to the drag from agriculture. The country's relatively large trade exposure to Europe also presents a strong downside risk for 2H.

Brexit is a reflection of how global politics can have a severe impact on the region, and a crowded political calendar in the EU and US suggests ongoing risks. However, we think that investors should be focused more on political developments occurring *within* ASEAN: from the new policies of President Duterte to Jokowi's coalition-building in Indonesia. These developments and the potential for reforms are grounds for some optimism and justify the relative outperformance of certain economies. In this edition of ASEAN Perspectives, we expand on the aforementioned political trends by country: a one-stop shop on all you need to know about ASEAN politics this year (page 3).

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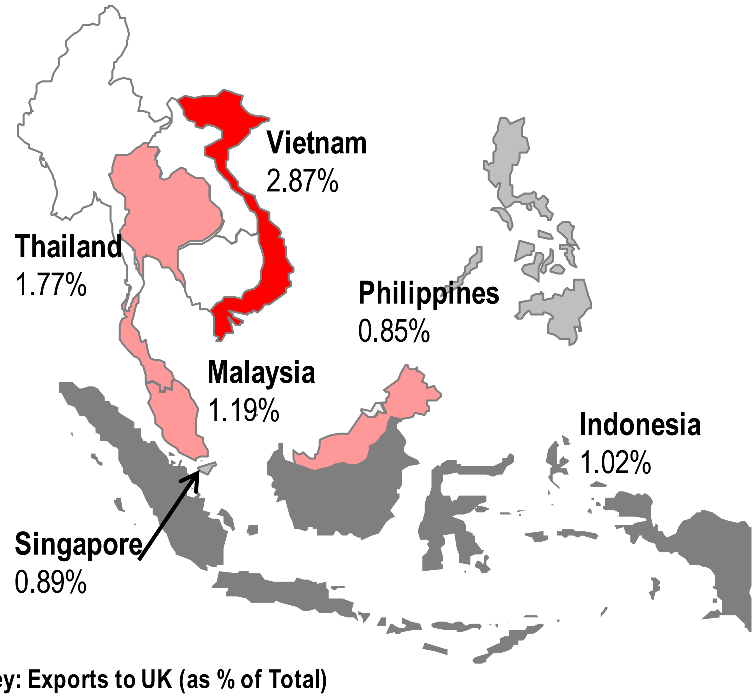
The impact of Brexit on ASEAN: Exports to the United Kingdom



Source: CEIC, HSBC

HSBC ASEAN research recent reports

	Date	Report
Indonesia	27-Jun	Indonesia's tax amnesty: Top five questions
	16-Jun	Indonesia: BI resumes easing, more to come
	15-Jun	Bank Indonesia Watch: Easy does it
	1-Jun	Indonesia: PMI expansion moderated in May; inflation within target
Malaysia	1-Jun	Malaysia: PMI shows May manufacturing shrinking for a fourteenth month
Thailand	22-Jun	Thailand's Policy Rate: On hold as expected: 2016 outlook little changed
	20-Jun	Bank of Thailand Watch: More reasons to stay on hold
	8-Jun	As rainy season begins, prospects brighten for Thailand: Latest op-ed published by The Nation
	1-Jun	Thailand Activity Data (Apr): A slow start to Q2
Vietnam	1-Jun	Vietnam at a glance: When the fiscal rubber meets the road

Key data/event to look out for next month

Country	
Indonesia	The dovish BI meets on policy on 21 July
Malaysia	BNM decides on policy on 13 July
Philippines	President-elect Duterte and VP Robredo to be inaugurated on 30 June
Singapore	The advance estimate of 2QGDP to be released in the first week of July
Thailand	Business Collateral Act 2015 effective on 2 July. New low-cost payment gateway "PromptPay" online on 15 July
Vietnam	July CPI to be published on 24 July

Source: HSBC

What does political change mean for ASEAN's reforms?

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Introduction

There have been important changes in Asean's political landscape in recent months.

At the beginning of the year, Vietnam installed a new Prime Minister, replacing a candidate widely viewed as having spearheaded reforms over the past decade. The Philippines also elected a new President in May, but he is widely viewed as taking a hard-line stance on issues such as crime and domestic and foreign policy (*Washington Post,* 10 May 2016).

By contrast, and perhaps more reassuringly, over in Indonesia the pro-reform ruling coalition has been benefiting from shifting political allegiances, and its initial minority presence in parliament has now turned into a majority. Then there's Malaysia. Despite the troubles with sovereign wealth fund 1MDB, the results of a state election and two federal by-elections suggest that the ruling coalition remains in a strong position ahead of general elections in 2018. Last but not least, there's Thailand, which will vote in a referendum on the draft constitution in August. If approved, this could lead to an election in 2H 2017, potentially paving the way for the country to emerge from over two years of military rule.

What will the above political shifts mean for structural reforms and the longer term economic outlook? In the following sections, we look at the reform agenda of each country in detail, and how the recent or upcoming political changes might impact these. Some of the desired reforms, such as the need for greater investment and in particular, infrastructure, recur across the region. Government balance sheets in some places will also need to be kept in check, and trade liberalization pursued. But policymakers are approaching all of these issues in their own unique ways, and change is afoot.

Indonesia: Improving dynamics

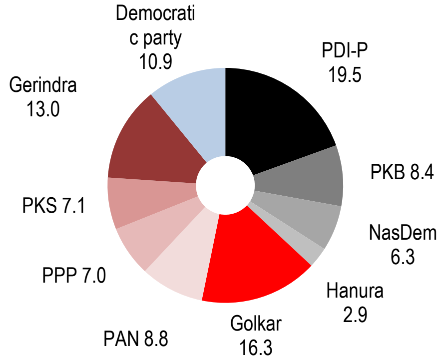
Jokowi consolidates power

When the reform-minded Joko Widodo (Jokowi) took office as President on 20 October 2014, he did so with minority support in parliament. At the time, his coalition consisted of just four parties representing 207 – or a mere 37% – of the 560 seats in the House of Representatives (or DPR; Chart 1).

Jokowi's ruling coalition has gone from a parliamentary minority to a thumping majority

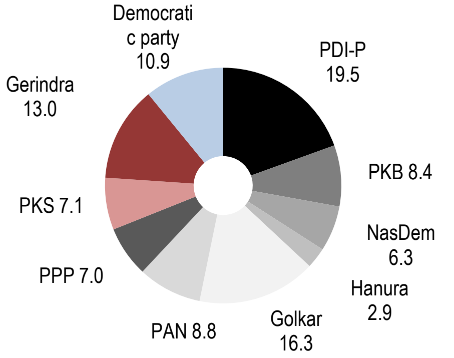
Over the past year-and-a-half, however, the political dynamics have slowly but surely shifted in Jokowi's favour. Various opposition parties have been switching allegiances to join his coalition. January in particular was a milestone, when the coalition's parliamentary representation reached a majority for the first time (at 53%). But the most important swing was in May, after Golkar also switched sides to join Jokowi's coalition. As Indonesia's second largest party (after Jokowi's PDI-P), Golkar's views on policies can greatly influence the populace. It also has a significant parliamentary presence – thanks to its switch in allegiance, Jokowi's coalition now represents 69% of the House, versus 20% for the opposition (the neutral Democratic Party accounts for the remaining 11%; Chart 2).

1. Then: House of reps in October 2014



Key: Blacks and greys = ruling coalition; reds = opposition coalition; blue = neutral
Source: DPR

2. Now: House of reps in May 2016



Key: Blacks and greys = ruling coalition; reds = opposition coalition; blue = neutral
Source: DPR

Positive implications for structural reforms

To be sure, quantitative domination of the House by the ruling coaltion does not mean that Jokowi will find automatic support for his policies. To keep his allies happy, the reality is that, from time to time, he will still have to balance the interests of those both within and outside his party.

A large House majority should smooth the reform path; there is much to be done in the next few years

A large majority in the House will at the very least make the path of reform an easier one. As a case in point, last year, when Jokowi was in power but the opposition coalition still dominated the parliament, just three bills were passed into law, the lowest number in at least five years. Decision-making simply cannot carry on at such a hobbled pace, for the Jokowi administration has its work cut out over the next few years – in line with its goal longer-term plans to achieve economic growth of 7% by 2019, 159 bills have been prioritized for parliamentary discussion over the five-year legislative cycle ending 2019. Of these, 40 new laws or amendments have been prioritized this year.

Corruption is a big one to tackle; a House majority ensures the anti-corruption fight continues

Many of these bills aim to tackle important but politically difficult issues, and this is where Jokowi's stronger power base will prove crucial. Take corruption, for one. Year after year, corruption has been consistently cited by investors as the most problematic factor for doing business in Indonesia (Chart 3). This has in turn hampered Indonesia from attracting even more capital and increasing its global competitiveness.

To be fair, Indonesia has made some progress in tackling corruption over the last few years. In its latest Global Competitiveness report, the World Economic Forum highlighted that "… efforts to tackle corruption – a priority for the previous as well as the current administration – are paying off, with Indonesia improving on almost all measures related to bribery and ethics." Indeed this is corroborated by the gradual improvements in perceptions of corruption in the country over the last few years (Chart 4). In fact, in 2015 Indonesia even pipped the Philippines.

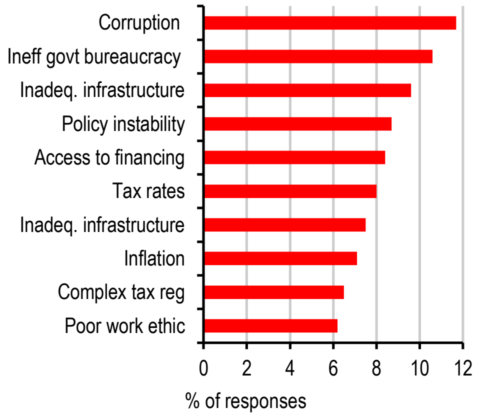
Now that the ruling coalition has a strong majority, the odds are that the momentum of the anti-corruption fight will at least continue. We had a preview of what a cohesive parliament can achieve on this front last January, when the House unanimously overturned an earlier (and worrying) opposition-led decision to end direct regional elections. Had that reversal not occurred, the opaque system of political patronage might have become even more entrenched.

To this end, in the coming quarters we will be keeping a close eye on two pieces of legislation to be discussed in parliament. The first is the debate over amendments to the law governing the Corruption Eradication Commission, or KPK, which could result in the commission's powers being significantly curtailed. This bill is on parliament's priority list this year, and its revival was led by Jokowi's own party, amid rising tensions between legislators, the KPK and the police.

The second is the Legislative Institution Law. Following opposition-led amendments earlier, this law is perceived as having opened up room for greater corruption in the legislature (the Speaker is now elected by the House, rather than automatically coming from the dominant party). The amended law also makes it administratively harder for the KPK to investigate lawmakers for graft.

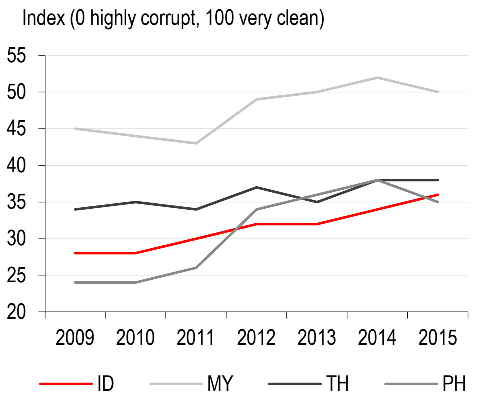
Political cohesion will be needed to support infrastructure development

3. Most problematic factors for doing business in Indonesia



Source: WEF Global Competitiveness Report, 2015-2016

4. Perceptions of corruption in Indonesia have been improving



Source: Transparency International

Another key area of development where political cohesion will be needed is infrastructure. As Chart 3 shows, as with corruption, inadequate infrastructure ranks as one of the top hindrances to doing business in Indonesia.

To be sure, Jokowi has placed infrastructure development at the front and centre of his policy agenda. But his administration faces an enormous task on many levels – according to the government, the country will need some IDR5,500trn (or just over USD400bn) of roads, power plants, airports, ports and so on from now until 2019, if its long-term GDP growth target of 7% is to be reached. A high degree of political cohesion and a shared vision of the future will therefore be crucial to achieving these goals – politicians on all side will need to agree on plethora of reforms and legislative changes for the physical and financing needs of the plan to be met.

So far, despite Jokowi's coalition having lacked a strong majority until recently, there has been sufficient parliamentary support to achieve some key changes. These include changes to the Land Acquisition Act, making it easier for land to be acquired for infrastructure purposes, as well as a reform of the legal framework supporting public-private partnerships.

Now that Jokowi's coalition is in the majority, measures to aid the infrastructure push could face less contention and be passed more expediently. A recent example of how 'difficult' such discussions can get is the injection of capital into state-owned enterprises (SOEs). IDR50.98trn has been allocated in this year's revised budget for this purpose, but only after much debate. Many of these SOEs will be involved in helping various infrastructure projects come to fruition and would benefit from a direct disbursement of funds (rather than slower disbursement via the Public Works Ministry). The injection is also intended to signal to investors that the government is willing to commit financially to infrastructure projects alongside private stakeholders. Some parliamentarians had voiced opposition to the plan, as some of these firms have been characterized by inefficiencies and graft (*The Wall Street Journal,* 20 April 2015).

In the coming months, the House will also have to debate and hopefully approve the Indonesia Development Bank, so that the institution can open its doors in 2017 as planned. This infrastructure bank will be key in helping the government tap funds from global and domestic multilateral sources, and channelling these funds quickly and efficiently to state-owned firms (*Jakarta Post,* 27 October 2015).

It is crucial that the various political parties buy into the need for stronger financial architecture – the central government is intending to fund just 30% of the IDR5,500trn needed until 2019, with the remaining 60% coming from state-owned firms, regional governments and the private sector. And as we saw both last year and this year, central government funding faces its own uncertainties, particularly if economic growth is slow and the state's commodity-dependent revenue come under pressure.

Political support crucial too for fiscal reform; some impressive achievements already made, but fuel prices may be the next big test

This brings us to fiscal reform, the third area where strong political and legislative support for Jokowi will prove paramount. To be sure, some significant hurdles on this front have already been crossed. These include the abolishment of fuel subsidies last January (after decades of the government providing cheap fuel to the population), and more recently, the passing of the tax amnesty bill earlier this month after a multi-month delay. Both of these promise to unlock significantly more financial resources that can be used in more productive areas such as infrastructure development (for more details, see *A watershed moment: Indonesia scraps gasoline subsidies*, 5 January 2015, and *Indonesia's tax amnesty: Top five questions,* 27 June 2016). They will also free up room for tax reform, which will help to improve the country's attractiveness as an investment destination, as well as its overall competitiveness. The capital gains tax on Indonesia's global bonds has already been scrapped, and now personal and corporate tax reductions may be imminent.

But there are still challenges to come, and a cohesive legislature will be necessary to enable Jokowi and his administration to stick with the reform agenda. In particular, should global crude oil prices continue this year's upward creep over the course of the year, it will be interesting to see if the government eventually also upwardly revises domestic pump prices. Somewhat surprisingly, domestic pump prices have been trimmed this year, though admittedly some allowance has to be given for lags as pump prices are adjusted only on a quarterly basis.

Nevertheless on balance the strengthening of Jokowi's coalition can only be good news for the economy. Corruption, poor infrastructure and a lack of fiscal headroom have posed some of the largest constraints Indonesia's economic performance for the last few decades, but as the Jokowi administration tackles these issues slowly but surely, in the longer term the economy will come that much closer to achieving its full potential.

Malaysia: On an even keel

PM Najib rides out the noise

Despite the negative headlines surrounding troubled sovereign development fund 1MDB, Prime Minister Najib Razak and his ruling coalition have in recent months passed not one, or two, but three closely watched popularity tests. These include a landslide win in the Sarawak state election – the ruling coalition now dominates 88% of the state's legislature – and increased margins (compared to 2013) in two recent by-elections in Selangor and Perak.

PM Najib's coalition has cruised to victory in a state election and two by-elections

To be sure, these wins were achieved on local rather than national issues. Neither will the outcome of the by-elections tilt the balance of power in parliament. Nevertheless, the wins provide an indication of how rank-and-file voters view PM Najib. Support from Sarawak is especially crucial – without its votes, PM Najib's government would have lost the 2013 general election.

The victories will enable PM Najib to defy opposition-led calls to resign over 1MDB, and have even led to speculation that the he may capitalize on his position of strength and call for a snap election – the next general election has to be called before 24 August 2018 (*Reuters,* 19 June 2016). Indeed, the PM has been coy on this topic, telling local media "I can only say the general election will be held after Hari Raya. But as to which year's Hari Raya, I don't know" (*Malaysiakini,* 23 June 2016).

Status quo for the reform agenda

With PM Najib's leadership intact for now, the status quo on structural reforms is likely to be maintained. This is good news for the Malaysian economy, as this means that key policy changes will continue to be pursued.

The Najib administration will continue pursuing fiscal reforms, though these are unlikely to be a dramatic as before

One important area where efforts will need to be kept up is fiscal reform, particularly as the country's sovereign debt ratings remain under scrutiny from ratings agencies. To be sure, the government's track record here so far has been highly commendable. This includes the bold and unexpected abolishment of fuel subsidies in November 2014, which has freed up resources for sectors more important to the country's socio-economic development, such as agriculture, rural development, health and education.

Last April the Najib administration also finally implemented a Goods and Services Tax (GST) of 6%; discussions on this have been on-again, off-again for more than a decade. The move should eventually make Malaysia's tax system more efficient, effective and transparent. Importantly the GST will also be a much-needed source of stability for state revenues. As Chart 5 shows, over the last few decades Malaysia had become unhealthily reliant on direct tax revenue. But this trend has started to reverse thanks to the GST, with indirect tax collections increasing noticeably in 2015. The GST also helps to reduce reliance on oil and gas-related revenues, which have on average accounted for a significant 35-40% of total revenues in previous years but are now coming under pressure owing to depressed energy prices (Chart 6).

Given how substantial recent fiscal reform measures have been, in the coming quarters it is unlikely that similarly big-bang measures will be announced. Nevertheless reform momentum – particularly with regards to revenues – will continue through a variety of channels. For example, in order to enhance the efficiency and amount of tax collection, the government will up its compliance and auditing efforts on tax evaders. This includes special consideration on relaxing penalties for tax evaders who come forward and declare their past income and settle their tax arrears before 31 December 2016.

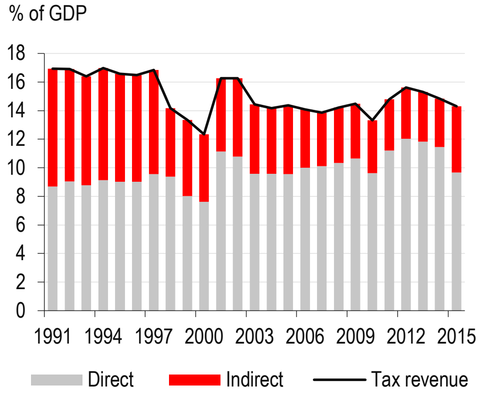
On the duty-free islands of Labuan, Langkawi and Tioman, the government will also limit the sale of cigarettes and liquor to duty-free outlets license by the customs department, helping to reduce leakages of nearly MYR1bn. The free duty treatment on imported vehicles on these duty-free islands will also be tightened. Lastly the government has also set about trying to raise revenue from the sale of telecommunication spectrum. Anecdotal reports suggest that the government is moving on this more quickly than expected.

Trade and investment ties will continue to be nurtured and expanded, helping to support Malaysia's long-term economic growth

Going forward, PM Najib's reaffirmed authority will also allow the government to continue nurturing and expanding its trade and investment ties. This will be important for Malaysia's longer-term growth prospects, particularly as global growth looks poised for a structural slowdown.

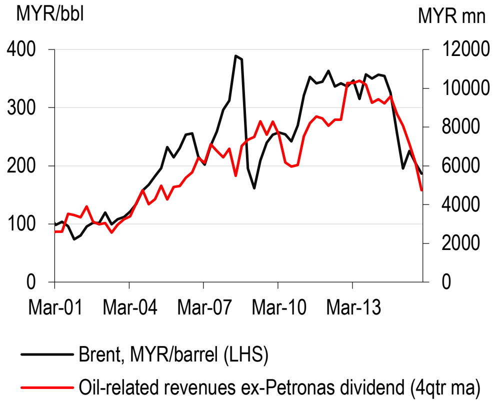
In particular, the administration's focus is likely to remain on China and Asean. Under PM Najib, Malaysia has always been receptive to China's One Belt, One Road policy to promote economic co-operation between Asia, Europe and Africa along five different routes. As China develops

5. Malaysia's indirect sources of tax revenue have been shrinking



Source: CEIC, HSBC

6. Compression of state oil & gas revenues amid depressed energy prices



Source: CEIC, HSBC

these routes – Malaysia sits along the Maritime Silk Road – we can expect Malaysia to benefit significantly from Chinese investment in its infrastructure. For instance, China has already publicized its interest in cooperating on high-speed rail projects with Malaysia, having struck similar deals in Laos, Indonesia and Thailand.

Malaysia is also working hard to negotiate the China-led Regional Comprehensive Economic Partnership (RCEP). This is a free trade area that will include the 10 Asean members as well as Australia, China, India, Japan, South Korea, and New Zealand, and should benefit Malaysia substantially once it is passed (plans are to seal the deal by the year-end).

Co-operation with China and Asean will be in focus, and may help to partially offset any disappointments should the TPP fail to be ratified

The eventual conclusion of RCEP may help to partially offset the missed opportunities from the US-led Trans-Pacific Partnership agreement (TPP), should the latter fail to be ratified following a change in US leadership. Partially, because the TPP is huge – although the agreement does not include China, it can potentially provide Malaysia greater access to developed markets such as the US and Japan, as well as markets traditionally closer to the US such as Mexico. In contrast, RCEP will provide Malaysia greater access to emerging markets within Asia, where trade policies have already been relatively liberal for some time. According to the World Bank, the TPP could potentially boost Malaysia's economy by as much as 8% by 2030, as its exporters get an advantage over regional competitors that aren't part of the bloc, including Thailand, the Philippines and Indonesia.

Potential hits and misses aside, the bottom-line is that with PM Najib having consolidated his position for now, the reform agenda can carry on uninterrupted. On the fiscal front, some big-bang reforms have already been made in the form of the long-awaited GST and abolishment of fuel subsidies. While this suggests that equally dramatic fiscal change is likely to be limited in the quarters ahead, the administration has indicated that it will still continue to work on smaller measures that can still help to restructure state finances. It will also continue to capitalize on the cosy trade and investment ties it has built particularly with China and Asean, which should help to keep Malaysia's longer-term growth supported amid a structurally challenging global backdrop.

Thailand: Winds of change

A referendum, and an election

Referendum on draft constitution on 7 August; military expects election in 2H 2017

In what is likely to be a closely watched event, Thais will vote in a referendum on the draft constitution on 7 August, slightly more than two years after the military took power in May 2014. This is the second draft constitution drawn up since the coup – the first was rejected by a reform council last year – and, if approved, will become the 20th constitution in Thailand's 84-year old democratic history.

According to plans contained in the interim constitution, if this new charter is passed, it will take 6-8 months of legal processes to put into effect. Preparations for a general election would take another four months. As such, the military government has projected that an election may be held in 2H 2017.

Maintaining the reform agenda

In recent years, political uncertainties have caused some delays in the implementation of some reforms, particularly with regards to infrastructure development. While it remains difficult to gauge the progress that's been made on reforms so far, we note that some key measures have been implemented recently (see Table 1).

Fiscal reforms needed to broaden the tax base and boost revenue, and provide headroom for other growth-boosting incentives

Of particular importance is fiscal reform, which will help the government broaden its tax base and boost revenue, and in the longer-term also lift economic growth as scope for investment-related and other incentives is increased. Although at 20% of GDP Thailand's tax revenues are not the lowest in Asean (think Indonesia's 11-13%, for instance, which we elaborated upon earlier), it is significantly lower than most developed economies and even many other developing economies.

Table 1. Thailand's current reform plans

Reform	Issue	Impact from political changes
Transportation infrastructure & water management Infrastructure	This is key to raising productivity and crowding in private investment. Success of the Special Economic Zones will also depend on it. For disaster prevention, water resource conservation, and sustainable growth for agriculture and industrial sectors.	The cabinet has identified 20 key projects to focus on, and approved several of them. Past political uncertainties have caused some implementation delays but not an overhaul of the plan. The projects can be approved and financed separately. The major floods in 2011 and recent drought proved this urgent. There are long-term plans, but implementation of large-scale projects remain slow. Amid economic weakness and political uncertainties, water management plans could become of lower priority and get pushed back.
Fiscal reforms	Strengthening of fiscal cash flows, ensuring fiscal sustainability.	Changes made include modernising personal income tax structure and the passing of a new inheritance tax bill. The land and buildings tax bill was also approved by the Cabinet in June 2016 (see our *fiscal reform report*).
State enterprise (SOE) reform	Raising the efficiency and transparency of state enterprises and, hence, improvement of public services and economic productivity	Reforms are already taking place, overseen by the State Enterprise Policy Commission, including restructuring of financially-troubled SOEs. A draft bill governing 57 SOEs is likely to be tabled for parliamentary vote by Q3 2016.
Raise regulatory standards for international compliance	1. Labelled "Tier 3" under US Trafficking in Persons Report, 2. ICAO's* warning on civil aviation controls, 3. EU's yellow flag on IUU** fishing	The government has indicated its commitment to follow up and rectify these issues and has so far implemented regulatory (e.g. amendments of Anti-Human Trafficking Act 2015 and Air Navigation Act B.E. 2497, enacted Royal Ordinance on Fisheries 2015) and preventive measures. But given the scope of the problems, time is required for lasting resolutions. Any delay in the reforms could have indirect but substantial impact e.g. limiting charter flights affecting tourism growth and the country's image, reduced economic co-operation etc.
Agricultural reforms	To raise productivity, market accessibility and information dissemination in the agricultural sector; improving the state support system; ensuring the availability of affordable farm land.	Many plans have been suggested and drawn up e.g. improving supply-demand information, empowerment of farmers, encouraging value-added products, land-zoning to prevent oversupply/over-cultivation etc. This is a long-term process and sustaining reform efforts here will require political will.
Energy reforms	Ensure energy sustainability, upgrade energy efficiency in the economy, and reduce price and demand distortions. Plans laid out in "Thailand Integrated Energy Blueprint 2015-2036".	Restructuring of retail oil and gas prices since 2014 has reduced demand and price distortions of diesel oil, liquefied petroleum gas, and natural gas. However, progress has been slow on some delicate issues e.g. amendments of the Petroleum Act (1990) and Petroleum Income Tax Act (2007). Resolving legal issues will likely advance energy reforms in a significant way.

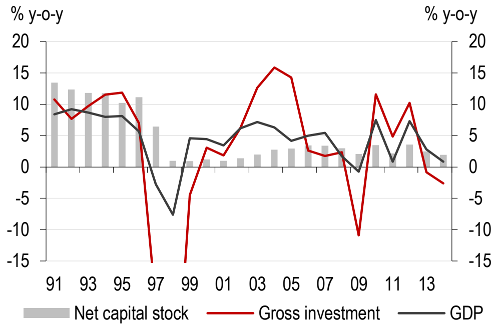
*ICAO refers to International Civil Aviation Organization
**IUU refers to illegal, unregulated, and unreported fishing
Source: Royal Thai Government's website, The Bangkok Post, HSBC

Government revenue is also heavily reliant on cyclical sources, with some 60% of coming from personal and corporate income tax, as well as the Value Added (or consumption) tax. This has limited the government's ability to counter cyclical shocks, as revenue fluctuates closely with the pace of economic activity.

While our Thailand economist Nalin Chutchotitham discussed the finer details and implications of fiscal reform in *March*, some of the measures worth highlighting here include a proposed reduction in the highest personal income tax rate to possibly as low as 20% from 35% currently, possibly starting 2017. Such would bring the top personal tax rate in line with the corporate tax rate, which stands at 20%. According to Revenue Department officials, the tax cut could eventually result in higher tax revenue for the government, thanks to increased consumption (*Reuters,* 4 January 2016). While this measure could take some time to get passed, come 2017 certain tax changes involving more generous deductibility thresholds on personal income tax and an upward shift in the top taxable income bracket will take effect.

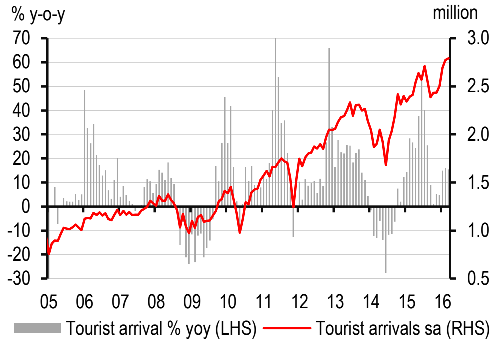
In a bid to reduce the cyclicality of overall government revenue, the revised Land and Building Tax Bill was approved by the cabinet in June. The government estimates that property tax revenue will double to THB60bn in the first few years, partly due to the progressive tax rates. However, the tax burden on most residential properties and agricultural land will not be significant. Owners of idle land, however, will have to pay higher taxes so as to encourage better use of such properties. The bill is now with the National Legislative Assembly (NLA) for the first, second and third readings, before it can become law and applied in 2017.

Chart 7. Investment growth has been disrupted by political uncertainties



NB: The latest capital stock database is up to 2014, based on 1988 price. Hence, GDP components also based on 1988 price, not 2002.
Source: CEIC, NESDB, HSBC

Chart 8. Political impact on tourism is significant, but usually short-lived



NB: Martial Law was imposed on 20 May 2014 and lifted on 1 April 2015.

Source: CEIC, HSBC

Last May the NLA also passed the country's first inheritance tax bill. Inheritors of assets worth over THB100m are now required to pay tax above that threshold, at a rate of 5% for descendants and 10% for others, and potentially generating about THB3bn a year in revenue for the government.

Measures to boost investment also underway

Closely tied in with fiscal reform are also measures to boost private investment, which has been sluggish for several years. For some time now, the Board of Investment (BOI) has offered a raft of incentives for eligible investors in targeted industries such as agro-industry, fisheries, logistics, tourism and manufacturing located in 10 special economic zones nationwide. But take-up has been slow, and in response the BOI has offered even more incentives and extended privileges to both existing and new eligible investors. For instance, those starting operations before the end of 2017 will get more incentives in the form of a 100% corporate tax exemption for nine to 12 years, up from the current eight years, plus an extra tax break of 50% for another five years.

Political change does not mean the reform agenda will be derailed; National Reform Steering Assembly to be regulated by new constitution

In the coming quarters, despite the prospect of political change on the horizon the reform agenda may not necessarily be derailed. Last October PM Prayut Chan-o-cha appointed the National Reform Steering Assembly (NRSA), an assembly comprising of 80 military officers and 120 civilians to compile and review opinions and guidelines related to the planned reforms of the country. While reform plans had already been completed by the now-dissolved National Reform Council, the NRSA's responsibility is to screen the agendas and bring the reforms into fruition, by finding the right approach or proposing legislations. The NRSA's mandate is not limited just to economic reforms, but also extends to other areas such as education, politics, social welfare and so on that still have long-term implications for the country. Importantly, the NSRA's operation will be regulated by the new constitution.

The Philippines: New beginnings

A new President

Rodrigo Duterte will take over as President on 30 June

The Philippines is set to undergo sweeping political changes in the coming weeks, after Filipinos voted for a new president, vice-president, 12 senators (half of the total) and all 292 members of the House of Representatives (the lower house of parliament) on 9 May. The changes won't stop here. At the regional level, Filipinos also voted for new governors and vice-governors of all 81 provinces, while 145 cities and 1,489 municipalities elected mayors, vice mayors and city council members.

Where to for reforms?

Given the strong role of the executive branch in the Philippines and the fact that the president usually wins support of the Congress, he/she has the ability to pass far-reaching reforms if desired. Accordingly, we need to focus on all signs of policy hints from the incoming president and his cabinet appointees, in particular how the government will allocate the budget.

Although Duterte's opinion on various policy subjects has been known to oscillate, he has been very consistent on the economy. He has continually pledged to maintain Aquino's priorities of (1) increasing infrastructure spending, (2) attracting foreign direct investment (FDI) by amending the constitution, and (3) continuing and beefing up the constitutional cash transfer programme; among others.

FDI policies could change for the better, though federalism needs to be approached cautiously

From a policy perspective, the biggest change comes from FDI initiatives. Partly due to limits on foreign participation in various industries, within Asean the Philippines has often been a laggard in attracting FDI (Chart 7). Duterte has repeatedly stated that he would be willing to make the constitutional changes for this.

He is also willing to make constitutional changes to implement a federal system of governance in the Philippines – another move that could have far-reaching consequences, as Manila would have to devolve some of its political and economic power to the regional and provincial governments. Duterte's ambitions on this front are partly fuelled by the fact that he hails from Mindanao, where residents believe that the region has been side-lined by politicians in Manila.

Potential peace in Mindanao would benefit the economy significantly

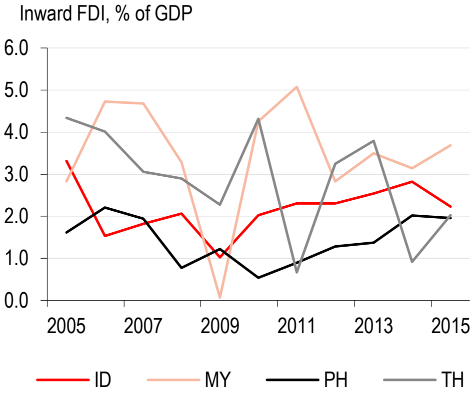
Due to political concerns, the Philippine Congress has not been able to pass the peace treaty that President Aquino signed with Muslim rebels, known as the Bangsamoro Basic law. Given his connection to the region, Duterte's victory could mean that the insurgency is eventually resolved and peace restored to the entire region. The benefits of lasting peace cannot be over-stated – Mindanao is one of the most fertile regions in the Philippines, and it could experience significant gains to growth as peace paves the way for greater investment in cash crops (such as pineapples and coconuts) as well as agricultural processing that would be of higher value-add.

The new administration needs to ramp up public spending

As for infrastructure spending, we hope to see the new government announce outlays upwards of 5% of GDP (the original 2016 target is 5.3%). More importantly, there needs to be a credible strategy on how to ensure that the funds are efficiently spent – according to our calculations, in 2015 the government spent just 2.6% of GDP on infrastructure, despite a 4.3% budget allocation. Incoming Budget Secretary Diokno announced that the government would target a budget deficit target of 3% of GDP (compared to the current target of 2%), alongside measures to ensure the various agencies meet their fiscal targets.

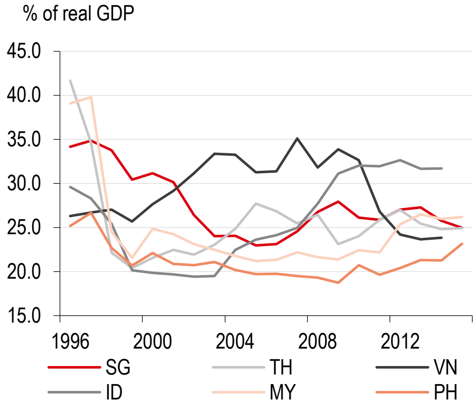
Given that quite a large number of lawmakers will be vacating their seats and replaced with someone new (or what is termed as 'electoral turnover'), there is potential for a complete change in political direction. Fortunately, Duterte has pledged to keep most economic policies unchanged, and we see the biggest potential changes stemming from the changes to the constitution to attract more FDI and enact Federalism. That said, the latter will have to be approached cautiously, with some political observers taking the view that Federalism could increase the incidence of corruption.

9. Philippines a laggard in the FDI race



Source: CEIC, HSBC

10. Investment share of GDP also low



Source: CEIC, HSBC

Vietnam: Old wine in a new bottle

A leadership reshuffle…

On 20 January, the Vietnamese Communist Party (VCP) held its five-yearly National Party Congress (NPC) to elect new leaders. One of the key leadership changes that emerged from that was instalment of Nguyen Xuan Phuc as Prime Minister (and economic manager). The former deputy PM replaced Nguyen Tan Dung, who had held the position for a decade. At the same time, Nguyen Phu Trong was re-elected to the top General Secretary position.

… but not a game changer for reforms

Foreign media have tended to portray Mr Dung as a reformer, keen on curbing the influence of the state sector in the economy, and Mr Trong as a conservative, leading to questions over the prospect of reforms (see, for example, "Vietnam's Secretive Communist Party Congress Meets to Pick New Leaders", *Bloomberg,* 20 January 2016).

The departure of the pro-reform former prime minister does not mean policies will become more conservative

But we do not think the 12th NPC will be a game changer for reforms. Aggressive trade liberalization, for example, reflects the consensus of the VCP and is an agenda item that Mr Trong has embraced. In July 2015, for example, the General Secretary made a historic, five-day visit to the United States where he met President Obama and signed a joint statement in which the US and Vietnam pledged to continue working in close collaboration to "further enhance economic and trade ties", the cornerstone of which is the Trans Pacific Partnership (though, as mentioned earlier, there are now some doubts over the chances of its ratification).

The incumbent General Secretary remains committed to the direction of reforms…

The *direction* of domestic reforms is unlikely to change either. The latest five-year socio-economic blueprint passed by the NPC reiterated plans to create "favourable conditions" to support the private sector and called for a "levelling of the playing field" so that firms enjoy equal access to credit, land, and resources. In his opening speech to the NPC in January, Mr Trong promised more support, saying that the "private sector is an important engine of the economy." (*The Diplomat,* 30 January 2016).

Turning this promise into reality requires progress on three fronts: (1) state-owned enterprise (SOE) reforms, (2) strengthening of the financial system, and (3) fiscal consolidation. The authorities need to back away from explicit or implicit guarantees unless the SOEs are systemically important for the economy. Those profitable entities that do not fall in this category should be sold away to the private sector with non-profitable companies going through a restructuring/liquidation process. For its part, the Vietnam Asset Management Company (VAMC) should get rid of bad assets on its books more quickly at a market clearing price: there is a five-year mandate for resolution of bad debts but, so far, the company has recouped less than 9% of the USD11.0bn in NPLs that it held on its books. On public sector finances, the authorities need to work on narrowing the still-sizeable primary deficit which will require both adjustments on the revenue and expenditure sides. Failure to address the problem would see the public debt ratio continue to march upwards in the next few years.

… though the speed of reforms is unlikely to accelerate

In the medium-term, we expect continued progress in the above reform areas, but we are less confident that domestic reforms will become bolder, or that their pace will accelerate. For example, we expect the government to continue divesting its stake in smaller SOEs in non-sensitive sectors, partly in response to greater financing pressures. Meanwhile, banking sector consolidation will likely continue, with the potential closure of several smaller, non-systemically important banks a possibility. However, the risk is high that progress on restructuring and privatisation of large SOEs, the acceleration of banking sector reforms (including the closure of weak, medium-size banks and loosening of ownership regulations), and public finance reform will remain slow. The low odds of bold domestic reforms also owe to the likelihood that reaching consensus on some of the larger reforms – except for those pertaining to trade liberalization, where views are cohesive – could take longer and be somewhat more cumbersome to achieve given the composition of the new politburo.

The momentum of reforms in the next five years will determine whether strong growth can be sustained into the future

The slow pace of reforms, if continued, would raise the risks that the weaknesses in Vietnam's domestic economy are left unaddressed, allowing imbalances to build up over time. This may not matter greatly in the near term, as the vulnerabilities at home are masked by the robustness of the export sector. But what happens over the next five years will have an important bearing on whether the strong growth of the last year can be sustained, enabling Vietnam to fulfil its potential and avoid the "middle income trap" (see also *Vietnam at a glance: the next five years*, 2 February 2016).

Key news events

Indonesia

After several months of delay, parliament finally passed the long-awaited tax amnesty bill into law. The amnesty window will start from 1 July 2016 and end 31 March 2017. Those declaring and repatriating their assets will pay a tax rate of between 2% and 5%, depending on how quickly they act. Those merely declaring their assets will pay a tax rate of 6-10%. Small to medium-size enterprises will pay a rate of 0.5-2.0%, depending on the size of their assets. The passing of the tax amnesty bill paved the way for the revised 2016 budget to be ratified; the latter assumes a IDR165trn boost to state revenue from the amnesty this year, and projects a budget deficit of 2.4%. The fiscal developments come after S&P refrained from lifting Indonesia's sovereign debt rating a notch higher to investment grade. But it kept the sovereign on positive outlook.

Malaysia

The Ministry of Finance said the government continues to implement various measures to achieve its 2016 budget deficit target of 3.1% of GDP, by optimizing expenses and prioritizing projects. Further, PM Najib assured that federal government debt remains manageable. Elsewhere, troubled sovereign wealth fund 1MDB said Moody's withdrawal of its rating on the US$1.75bn bond issued by 1MDB Energy owed to "Moody's own business reasons". 1MDB reiterated that its liquidity position was strong, and emphasised that the withdrawal had occurred without any downgrade in the Aa2 rating for its Energy Notes. S&P rates the notes at AA.

Philippines

President-elect Rodrigo Duterte will be inaugurated on 30 June. The inauguration speech may not reveal too many new details concerning upcoming policy. However, Mr Duterte has already announced all the cabinet appointments and we are impressed with the caliber of the new economic team. Many come from academia and have past policy experience; accordingly, we expect them to hit the ground running and to expeditiously start implementing reforms. For example, we know that the new government will target a budget deficit of 3% of GDP.

Singapore

In April the Monetary Authority of Singapore (MAS) adopted a flat slope – removing the "modest and gradual appreciation" stance that the central bank had in place since 2010, while keeping other settings on hold. In the latest Recent Economic Developments report released since the April meeting, the MAS did not materially downgrade its view of the economy. Core inflation is still expected to come within the 0.5-1.5% forecast range, albeit in the lower half, while growth is foreseen between 1% and 3%. Brexit poses some risks to global growth and trade, and heightened volatility may impact financial centres such as Singapore. Should risks to Singapore's growth outlook increase in the coming months, then there is a risk of a downward re-centring of the SGDNEER band in the October MPS meeting.

Thailand

The Bank of Thailand (BoT) maintained its 2016 growth forecast at 3.1% but lowered its 2017 growth estimate to 3.2% from 3.3%. The BoT expects domestic demand to hold up, but cited downside risks to exports. Separately, the BoT will, from 20 July, allow individuals and juristic persons with a portfolio of at least THB100m (Qualified Investor) to directly invest in foreign securities, derivatives linked to foreign variables, and securities issued by or sold in designated countries, with a limit of USD5m per person per year. The Cabinet on 28 June approved a THB300bn Eastern Economic Corridor Development plan (Phase 2) proposed by the NESDB. But details of the plan will be announced in three months. The government estimates that the project will crowd-in some THB1.9trn of private investment. Another fiscal stimulus measure announced was the new round of policy loans (THB30bn) targeting productivity enhancement in SMEs.

Vietnam

Financial sector reform – including the clean-up of legacy non-performing loans (NPLs) – is among the most important structural reforms that Vietnam needs to tackle. Reports that the Vietnam Asset Management Company (VAMC) will make its first cash purchase of NPLs this year is therefore good news. The VAMC until now offered special bonds to buy NPLs from banks. Banks could use this collateral to secure funding from the central bank. However, this mechanism did not allow for the re-capitalization of banks. The switch to a "true-sale"--even if only partial--could help accelerate the reduction of NPLs and boost banks' loss-absorption capacity at the same time. That said, it is unclear whether the scheme would be big enough to be effective--at VND2trn (USD89.5m), the VAMC's capital base is limited relative to the size of outstanding NPLs.

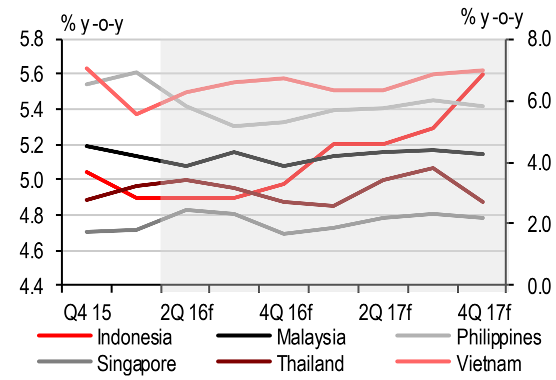
A snapshot of ASEAN data

ASEAN-6 macro-economic framework (quarterly)

	Q4 15	1Q 16	2Q 16f	3Q 16f	4Q 16f	1Q 17f	2Q 17f	3Q 17f	4Q 17f
GDP y-o-y									
Indonesia	5.0	4.9	4.9	4.9	5.0	5.2	5.2	5.3	5.6
Malaysia	4.5	4.2	3.9	4.3	3.9	4.2	4.3	4.4	4.3
Philippines	6.5	6.9	5.8	5.2	5.3	5.7	5.8	6.0	5.8
Singapore	1.7	1.8	2.5	2.3	1.7	1.9	2.2	2.3	2.2
Thailand	2.8	3.2	3.4	3.2	2.7	2.6	3.4	3.8	2.7
Vietnam	7.1	5.6	6.3	6.6	6.7	6.3	6.3	6.8	7.0
ASEAN-5	5.0	4.8	4.7	4.7	4.6	4.8	4.9	5.1	5.0
ASEAN-6	4.6	4.5	4.5	4.4	4.2	4.4	4.6	4.8	4.7
CPI y-o-y, avg									
Indonesia	4.8	4.3	3.4	2.8	3.8	3.3	4.7	5.0	4.8
Malaysia	2.6	3.4	2.7	2.3	2.3	2.8	2.9	3.0	3.1
Philippines	1.0	1.1	1.9	2.7	2.7	2.7	3.0	2.9	2.9
Singapore	-0.7	-0.8	-0.8	-0.3	0.3	0.8	1.1	1.2	1.2
Thailand	-0.9	-0.5	-0.2	0.6	1.6	2.6	2.3	2.1	1.8
Vietnam	0.3	1.3	1.6	1.5	2.2	3.1	3.6	4.5	5.1
ASEAN-5	2.4	2.6	2.2	2.2	2.8	3.0	3.6	3.8	3.8
ASEAN-6	2.1	2.1	1.9	1.9	2.5	2.7	3.3	3.5	3.5
Exchange rate vs. USD									
Indonesia	13795	13118	13300	13400	13500	13500	13500	13500	13500
Malaysia	4.30	3.87	4.03	4.00	3.95	3.92	3.90	4.25	4.25
Philippines	46.90	46.00	46.00	45.50	45.00	44.80	44.60	48.50	48.50
Singapore	1.41	1.35	1.36	1.37	1.38	1.38	1.38	1.38	1.38
Thailand	35.99	35.10	36.00	36.20	36.40	36.40	36.40	36.40	36.40
Vietnam	22,485	22,293	22,300	22,600	22,800	23,000	23,000	23,000	23,000

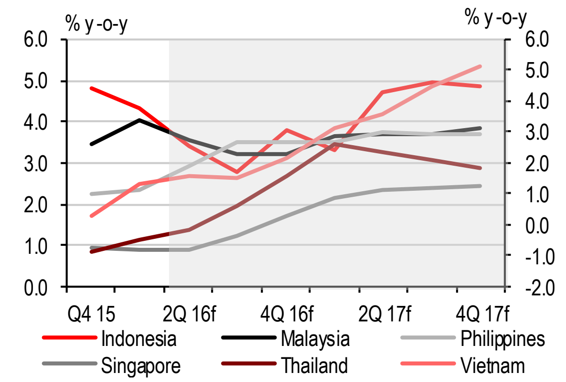
Source: HSBC

Growth remains relatively soft across ASEAN



Source: HSBC

Inflation will increase into 2016 due to base effects



Source: HSBC

HSBC policy rate forecasts

	Current	Last Move/Date	Next MPC	4Q15f	1Q16f	2Q16f	3Q16f	4Q16f	1Q17f	2Q17f	3Q17f	4Q17f
Indonesia	6.50	-25bp (Jun 2016)	21-Jul	7.50	6.75	6.50	6.25	6.25	6.25	6.25	6.25	6.25
Malaysia	3.25	+25bp (July-2014)	13-Jul	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25
Philippines	3.00	-100bp (May-2016)	11-Aug	4.00	4.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00
Thailand	1.50	-25bp (Apr-2015)	22-Jun	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.75	1.75
Vietnam	5.00	-50bp (Mar-2014)	n/a	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.50	5.50
	Slope	**Last Move**	**Next MPS**	**April**	**October**		**April**		**October**		**April**	
Singapore	0.00	Reduce slope	14-Oct	Reduce Slope	No change		No change		No change		No change	

NB: Singapore monetary policy is conducted through a managed exchange rate system. The three possible monetary policy options are a change of the slope, the width of the band, and the level at which the midpoint is centred;
*January meeting was off-cycle
Source: Bloomberg, CEIC, HSBC forecasts

ASEAN-6 macro-economic framework (annual)

	2011	2012	2013	2014	2015e	2016f	2017f
GDP growth (% y-o-y)							
Indonesia	6.2	6.0	5.6	5.0	4.8	4.9	5.3
Malaysia	5.3	5.5	4.7	6.0	5.0	4.0	4.3
Philippines	3.7	6.7	7.1	6.1	5.8	5.9	5.8
Singapore	6.2	3.7	4.6	3.3	2.0	2.1	2.1
Thailand	0.8	7.2	2.7	0.8	2.8	3.0	3.1
Vietnam	6.2	5.2	5.4	6.0	6.6	6.3	6.6
ASEAN-6	4.9	5.9	5.1	4.5	4.4	4.4	4.6
CPI, average (% y-o-y)							
Indonesia	5.3	4.0	6.4	6.4	6.4	3.6	4.5
Malaysia	3.2	1.7	2.1	3.1	2.1	2.8	3.0
Philippines	4.7	3.2	2.9	4.2	1.4	2.1	2.9
Singapore	5.2	4.6	2.4	1.0	-0.5	-0.4	1.1
Thailand	3.8	3.0	2.2	1.9	-0.9	0.4	2.2
Vietnam	18.7	9.1	6.6	4.1	0.6	1.6	4.1
ASEAN-6	5.8	3.9	4.2	4.1	2.7	2.1	3.3
Current account balance (% of GDP)							
Indonesia	0.2	-2.7	-3.2	-3.1	-2.0	-2.4	-2.5
Malaysia	10.9	5.2	3.5	4.3	2.9	2.9	2.8
Philippines	2.5	2.8	4.2	3.8	2.9	2.4	2.0
Singapore	22.0	17.2	17.9	17.4	19.7	21.3	22.3
Thailand	2.4	-0.4	-1.2	3.8	8.0	8.4	7.3
Vietnam	0.2	6.1	4.6	5.0	0.3	-0.7	-1.3
ASEAN-6	5.0	2.7	2.2	3.1	3.8	3.7	3.5
Policy rates							
Indonesia	6.00	5.75	7.50	7.75	7.50	6.25	6.25
Malaysia	3.00	3.00	3.00	3.25	3.25	3.25	3.25
Philippines	4.50	3.50	3.50	4.00	4.00	3.00	3.00
Singapore	1.45	1.45	1.45	1.45	1.45	2.30	2.30
Thailand	3.25	2.75	2.25	2.00	1.50	1.50	1.75
Vietnam	14.00	7.00	5.50	5.00	5.00	5.00	5.50

NB: We use 3-month SOR for Singapore's policy rate
Source: HSBC forecasts

ASEAN sustainability matrix and financial indicators

	Stock of portfolio inflows since 2009 as a share of reserves	Short-term external debt as a % of reserves	FX reserves to M2	Import coverage ratio
Indonesia	94	37	31.0	8
Malaysia	30	88	23.8	6
Philippines	10	20	46.9	9
Singapore	127	65	63.1	7
Thailand	-11	34	38.8	12
Vietnam	22	38	10.9	2

	Short-term external debt as a % of GDP	External debt as a % of GDP	Household debt as a % of GDP	Loan-to-Deposit Ratio
Indonesia	4	36	16	92
Malaysia	27	67	89	84
Philippines	5	27	7	66
Singapore	55	431	75	97
Thailand	13	33	82	109
Vietnam	7	39	n/a	92

NB: Last available data per country
Source: CEIC, HSBC

Fiscal and debt monitor

	Budget balance (Local currency bn)			Budget balance (% of GDP)			Public Debt (% of GDP)		
	2015e	2016f	2017f	2015e	2016f	2017f	2015e	2016f	2017f
Indonesia	-292,100	-303,650	-306,950	-2.5	-2.4	-2.2	31.2	30.1	30.1
Malaysia	-39	-39	-39	-3.4	-3.2	-3.0	54.5	54.8	54.0
Philippines	-124	-210	-226	-0.9	-1.4	-1.5	47.7	44.7	40.9
Singapore	2	0	7	0.7	0.3	1.1	104.7	107.2	106.1
Thailand	-322	-457	-480	-2.4	-3.2	-3.2	43.1	45.3	47.0
Vietnam	-6,616	-6,630	-5,813	-6.0	-5.6	-4.2	62.7	65.0	66.5

Source: HSBC

Disclosure appendix

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The following economists, who are primarily responsible for this report, certify that the opinions on any views or forecasts expressed herein accurately reflect their personal views and that no part of their compensation was, is or will be directly or indirectly related to the specific recommendation or views contained in this research report: Su Sian Lim, Joseph Incalcaterra, Nalin Chutchotitham and Izumi Devalier

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