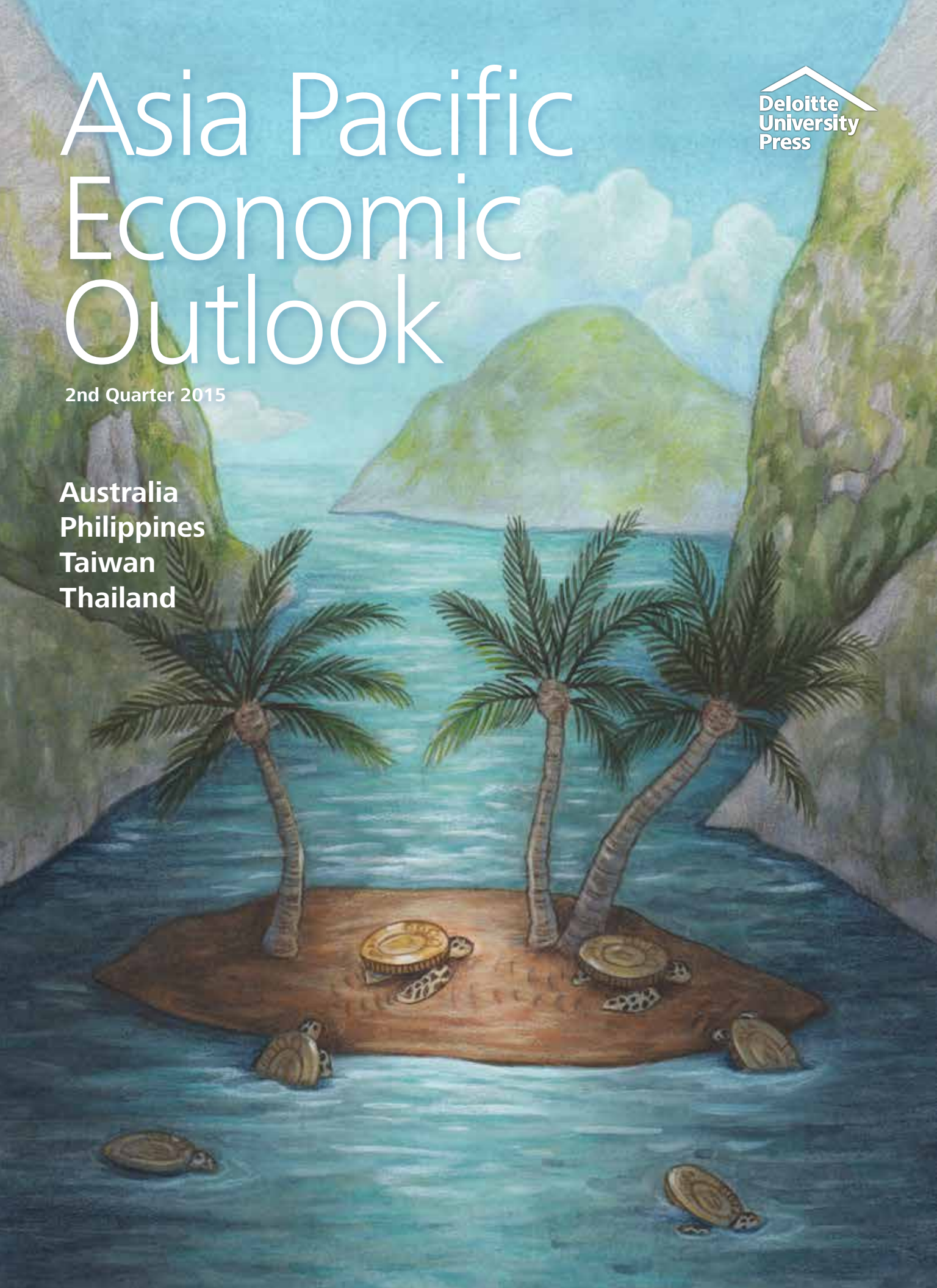
Asia Pacific Economic Outlook

2nd Quarter 2015

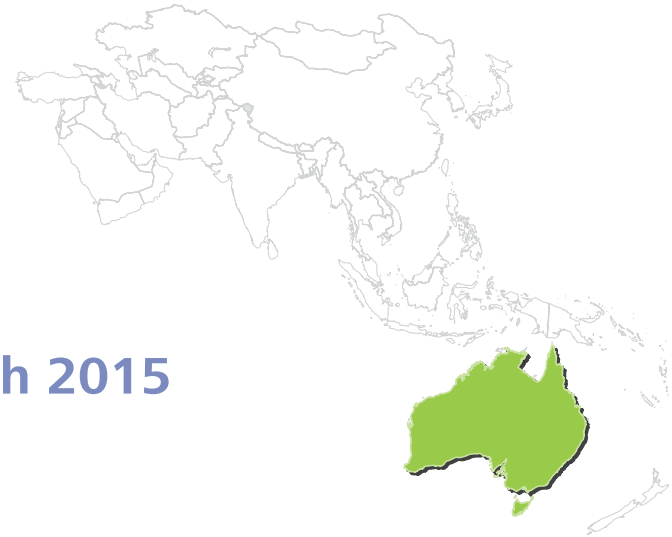
Deloitte University Press

Australia
Philippines
Taiwan
Thailand



With this edition of the *Asia Pacific Economic Outlook*, we transition from being a monthly to a quarterly publication. This publication will complement our quarterly *Global Economic Outlook*, which focuses on the world's major markets, including three Asian countries: China, India, and Japan. The new quarterly *Asia Pacific Economic Outlook* will focus instead on the smaller but important economies of the region. These will include Australia, Indonesia, Malaysia, the Philippines, Singapore, South Korea, Taiwan, Thailand, and Vietnam. Each quarterly report will cover a rotating collection of these countries as well as any additional topics we deem to be important to our readers' insight into the region. We hope that our readers will find this new approach to be interesting and useful. Naturally, feedback is most welcome.

Contents



Australia

Growth to limp through 2015

By Dr. Rumki Majumdar

AUSTRALIA'S economic growth slowed further in Q4 2014 to 2.3 percent year over year, in contrast to 2.7 percent in the previous quarter. Annually, the country's GDP grew at a below-trend pace of 2.5 percent in 2014. The momentum of national income growth slowed in the second half due to lower export prices for iron ore and coal. However, the strong investment in new capacity made in recent years is now coming onstream, meaning that export volumes remain the main contributor to economic growth. On the other hand, domestic demand remained weak throughout the year due to poor consumer and business spending. While a weak labor market, record-low wage gains, and high household debt weighed on consumption expenditure, sliding commodity prices and poor domestic demand resulted in weakening business investment.

The underlying labor market conditions remained soft, as evident from the rising unemployment rate, which increased to 6.3 percent in February—the highest in 13 years. Employers have been reluctant to employ permanent employees as they remain skeptical about economic growth prospects. The new monthly leading indicator of employment, which peaked in January 2014, has been falling since then.[1] In other words, employment growth has been weak since early last year, and recent monthly numbers indicate that employment could continue to grow more slowly in the coming months than indicated by the long-term trend.

Business investment remained weak as the economy struggles to transition from mining- to non-mining-led growth. Expectations of falling commodity prices and a surge in global mine supply in prospect post the rapid expansion during 2010–2013 have led to lower investment growth. So far, investment in non-mining sectors has failed to make up

for the winding down of a decade-long boom in mining investments. Total capital spending fell 2.2 percent in Q4, primarily led by a 5.4 percent drop in capital spending by the mining sector. Investment in sectors such as manufacturing, telecom, financial services, distribution, and construction increased, but the drop in mining sector investment offset these increases. Surprisingly, residential investment also fell in Q3 2014, despite the surge in building approvals and housing starts owing to low levels of mortgage lending rates and solid (if slowing) population growth.

On the positive side, weaker domestic demand, poor wage growth, the abolition of a carbon tax, and low international oil prices resulted in low inflation. Inflation was 1.7 percent in 2014 through Q4 compared with 2.3 percent in Q3 2014. At the same time, the average value of the Australian dollar depreciated 6.5 percent in 2014. On a trade-weighted basis, the Australian dollar was around 4 percent below its early 2014 levels, a relatively modest decline given the significant fall in commodity prices during the latter half of the year.

The combination of weak growth, modestly rising unemployment, and a lack of inflation threats led the Reserve Bank of Australia (RBA) to cut official cash rates for the first time in 18 months, reducing the official cost of borrowing to a record low of 2.25 percent. This unexpected move by the RBA in its first monetary policy meeting of the year (held in February) was intended to support domestic demand, which has remained below the average long-term growth trend.[2] Lower interest rates are likely to boost domestic demand and offset some of the decline in the investment cycle.

Future outlook

Growth is expected to remain modest this year before gradually picking up to an above-trend pace in 2016. A weak labor market will likely weigh on consumption expenditure, although low lending rates, rising housing wealth due to increasing house prices and a lift in equity markets, and falling fuel prices are expected to partially offset the impact. If global commodity prices remain low, that may, in turn, impact wages, profits, and government revenues. In addition, investment will likely remain patchy this year due to an expected fall in commodity prices, falling mining-related investment, and a slowdown in investment in Australia's largest trading partner, China. While lower interest rates, a depreciating currency, and stronger growth in the United States might cushion the impact on investment and trade, growth will likely remain in the range of 2.2–2.9 percent in 2015. Net export volumes will continue to be the key driver of growth, and a depreciated currency will further boost export growth in services in 2015.

The below-trend GDP growth and patchy investment outlook suggest that the unemployment rate may continue to remain high. In addition, the pace of wage increases and growth in unit labor costs will likely remain low. A weak labor market, poor domestic

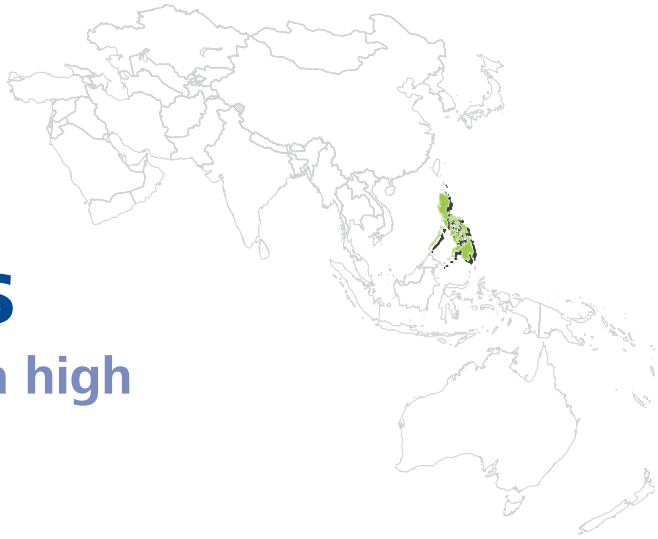
> So far, investment in non-mining sectors has failed to make up for the winding down of a decade-long boom in mining investments.

demand, and low international oil prices may result in a further fall in full-year inflation rates this year. Of course, a strengthening housing market and continued depreciation of the Australian dollar may offset this fall. Headline consumer price inflation is expected to be in the range of 1.4–2.0 percent this year, lower than the 2–3 percent target range of the RBA.

The RBA communicated in its February monetary policy meeting that it may reduce interest rates further to support growth because it expects inflation to remain within the target range.[3] The timing of the rate cut is yet to be decided and will be communicated in future monetary policy meetings. However, given large increases in house prices and the ongoing strong housing asset lending to investors, reducing interest rates might increase risks to the housing market. Thus the RBA has to weigh its options closely before considering whether to make monetary policy more accommodative.

Endnotes

1. Australian Government Department of Employment, "Department of Employment's leading indicator of employment latest release," February 2015, https://www.employment.gov.au/department-employment-s-leading-indicator-employment-latest-release.
2. Reserve Bank of Australia, "Minutes of the monetary policy meeting of the Reserve Bank Board," February 2015, http://www.rba.gov.au/monetary-policy/rba-board-minutes/2015/2015-02-03.html.
3. Ibid.



Philippines

Entering 2015 on a high

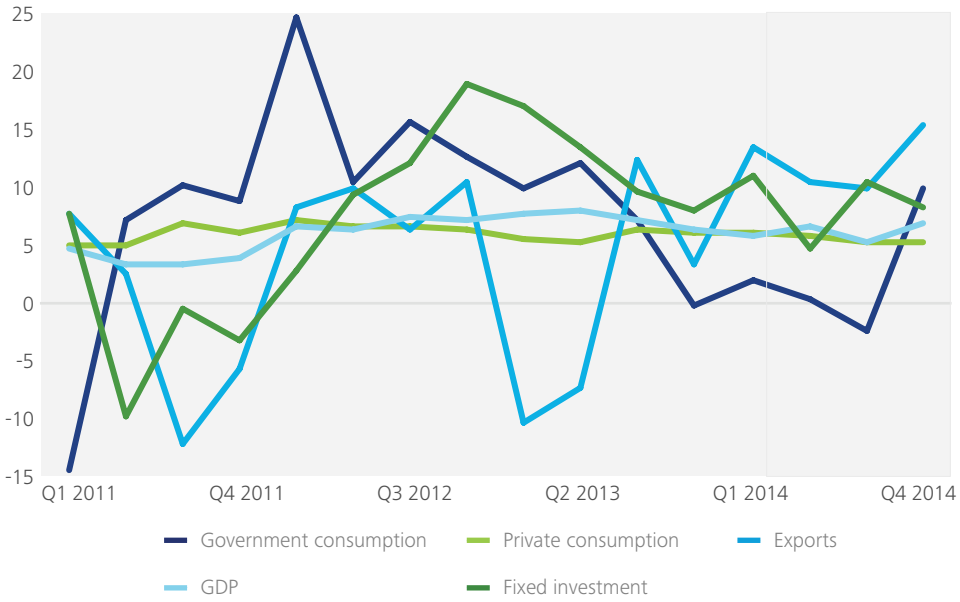
By Akrur Barua

FOR a long time, the Philippines was in the shadow of some of its more illustrious neighbors in Southeast Asia. Poverty, poor infrastructure, and workers migrating to greener pastures abroad had left the economy stranded. But things started changing in the past decade, especially the last few years; between 2010 and 2014, real GDP expanded on average 6.3 percent every year. The positive momentum is likely to continue in the medium term as policymakers try to set the foundation for sustainable manufacturing and services activity. Aiding the economy will be continued large remittances from overseas Filipino workers (OFWs). At last count, there were about 10 million of them.

Economy picked up pace in Q4 2014

Real GDP grew 6.9 percent year over year in Q4 2014, up from 5.3 percent in Q3. This took annual GDP growth in 2014 to 6.1 percent, yet another year of strong economic growth in a challenging global environment. Growth in Q4 2014 was primarily driven by exports, government expenditure, and private consumption (figure 1). Total exports grew 15.5 percent in Q4, up from 9.9 percent in Q3. External demand will remain healthy in 2015 as well, with a strong US economy likely to offset the impact of a slowing China and a weak Eurozone.

Figure 1. GDP growth continues to be strong in the Philippines



Source: Oxford Economics; Deloitte Research economic analysis.

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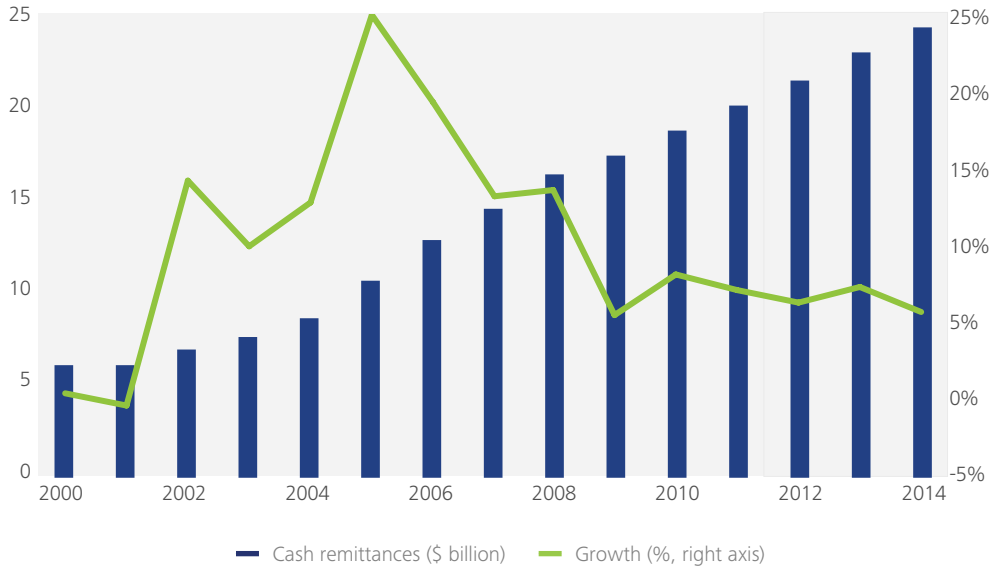
Government consumption grew 9.8 percent in Q4 2014, a reversal from the 2.8 percent decline in Q3. Spending had slowed in previous quarters as legal challenges resulting from allegations of corruption had hampered the allocation of contracts. This seems to have changed in Q4, and it is a positive development, given the need to improve infrastructure. Fixed investment growth was also strong in Q4 at 8.5 percent but was a tad lower than the previous quarter's 10.5 percent. However, with businesses optimistic about future economic prospects, private sector investment will remain strong in 2015, most likely in the range of 8–9 percent.

> With remittances set to stay high amid improving economic prospects, it is no surprise that consumer confidence in the Philippines is high.

Support from personal consumption continues

Private consumption growth also edged up in Q4 2014 to 5.1 percent from 5.0 percent in Q3; the overall rise in private consumption in 2014 was 5.4 percent. Consumers benefitted from strong economic growth, increased access to credit, rising remittances, and low inflation. A tighter labor market also helped. For example, the unemployment rate fell to 6.0 percent in Q4 2014 from 6.7 percent in Q3. This has kept income growth high, with the pace not likely to slow down in the near term. According to Oxford Economics, nominal personal disposable

Figure 2. Remittances went up 5.8 percent last year



Source: Bangko Sentral ng Pillipinas; Deloitte Research economic analysis.

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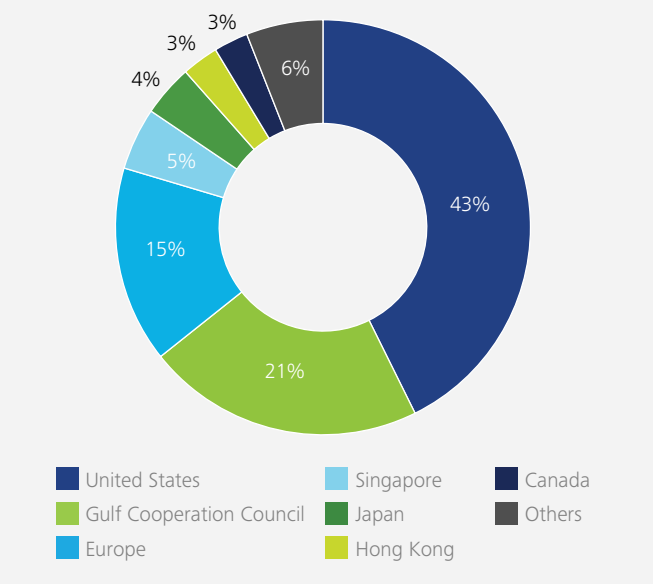
income will rise 9 percent in 2015, similar to figures for 2013–2014.[1]

Consumers also benefitted from real income gains late last year due to declining inflation. With energy prices staying low, this trend is likely to continue in 2015. The other key contributor to personal consumption growth in 2014 was remittances, which went up 5.8 percent to $24.3 billion last year (figure 2). With remittances set to stay high amid improving economic prospects, it is no surprise that consumer confidence in the Philippines is high. In Nielsen's Q4 2014 survey, the Philippines' consumers rank second along with Indonesia on the confidence list; India leads the tally.[2]

A few worries for remittances

There are, however, risks related to remittances this year. A slow European economy, which accounts for more than 15 percent of remittances, is a worry (figure 3). In 2014, inflows from Europe fell 5.5 percent. Inflows in US dollar terms have also been complicated by the euro's weakness relative to the dollar (as well as the Philippine peso). This could get worse, especially as the US Federal Reserve (Fed) looks at hiking interest rates and the European Central Bank continues quantitative easing.

Figure 3. Share in total dollar remittances by OFWs in 2014



Source: Bangko Sentral ng Pillipinas; Deloitte Research economic analysis.

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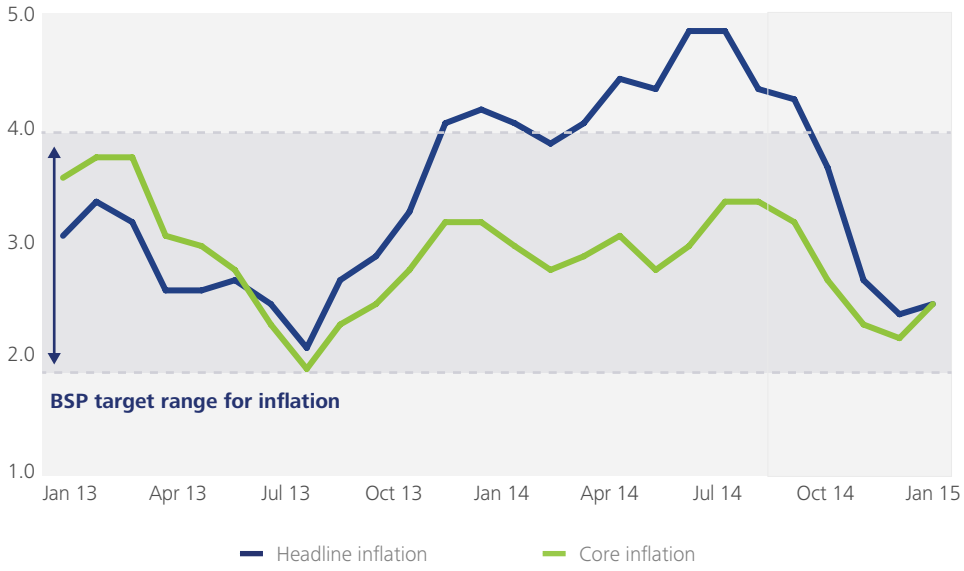
Figure 4. Inflation has eased in recent months



Source: Bangko Sentral ng Pillipinas; Deloitte Research economic analysis.

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In 2014, 21.6 percent of remittances came from the oil-rich countries of the Gulf Cooperation Council (GCC); Saudi Arabia and the United Arab Emirates accounted for a large share of that.[3] Unlike the euro, currencies in the GCC are largely pegged to the US dollar and hence pose no threat to the value of dollar remittances. However, falling hydrocarbon prices could dent growth in the GCC, resulting in reduced job opportunities and lower pay hikes for OFWs.

These concerns notwithstanding, remittances by OFWs will remain strong in the near term due to strong growth in the United States, which accounts for 42.7 percent of remittances by OWFs. Interestingly, as economic prospects at home improve for Filipinos in the medium to long term, the role of remittances in economic growth will slowly decline.

BSP has the upper hand in the inflation fight

The Bangko Sentral ng Pillipinas (BSP) kept interest rates unchanged for the second straight time in February 2015. BSP had raised rates twice last year (a total of 50 basis points) to keep price pressures in check after inflation rose to a three-year high of 4.9 percent in July 2014. Currently, BSP will be less concerned about inflation, given slowing energy and food prices. In January 2015, inflation came in at 2.4 percent, the lowest since August 2013. And although the figure edged up a bit to 2.5 percent in February 2015, it is comfortably within the BSP's target range of 2–4 percent for 2015 and 2016 (figure 4).

With the near-term inflationary outlook not likely to change much, BSP will keep rates on hold for now. Any change this year, if it comes, will follow a possible rate hike by the Fed later this year. BSP will, however, be less worried about the impact of the Fed's rate move on the peso than some other emerging economies will. The peso has strengthened by about 1.4 percent as markets take a positive view of Philippines' economic potential, current account surplus, sizable reserves, and steady fiscal health.

Hoping for better fiscal management and policy continuity

Public finances continue to be affected by a weak tax regime and failure to achieve spending targets. Corruption has also been an issue, with legal challenges in recent times threatening to derail the government's focus on much-needed infrastructure spending. Fortunately, national accounts data for Q4 2014 reveal that government spending is back on track. The announcement of a number of public-private partnership projects in February 2015 also suggests that the government has likely left behind some of its troubles.

On the tax side, however, there are concerns about the increasing demand for a reduction in tax rates and extension of tax breaks to more sectors. Such moves, without improvements in revenue collection, are fraught with medium-term risks to fiscal sustainability. The Philippines needs revenues to augment infrastructure and human capital, and to fight poverty. The other big medium-term challenge is policy continuity as President Benigno Aquino leaves office in 2016. With presidents limited to one term, economy watchers will be anxious that the new administration does not lose the strong gains made in the last decade.

Endnotes

1. Oxford Economics, "Global Economic Databank," March 2015.
2. Nielsen, "Filipino consumers tie with Indonesia as world's 2nd most optimistic in Q4 2014," January 2015, http://www.nielsen.com/ph/en/insights/reports/2015/q4-2014-filipino-consumer-confidence-report1.html.
3. The GCC includes Saudi Arabia, United Arab Emirates, Qatar, Kuwait, Oman, and Bahrain.

Taiwan

In the shadow of China

By Dr. Ira Kalish

TAIWAN'S economy faces contradictory influences. On the one hand, lower oil prices are having a positive impact on consumer purchasing power, thus boosting domestic demand. On the other hand, the worsening condition of the Chinese economy is hurting Taiwan's exporting prowess—although improvements in the US and European economies have the potential to provide a positive offset.

Positive effect of oil prices

First, consider oil. It accounts for roughly 10 percent of Taiwan's imports. The price of oil has fallen more than 50 percent in the past year, thus providing Taiwan with both lower inflation and increased purchasing power.[1] As of February 2015, consumer prices in Taiwan were down 0.2 percent from a year earlier, mimicking the deflation that many developed economies are now experiencing due to declining energy prices. At the same time, wages have been rising due to a relatively tight labor market. The unemployment rate is now 3.8 percent. Thus the real purchasing power of households is expanding, boding well for a strong increase in consumer spending in the coming year.

Moreover, lower global oil prices are having a positive impact on purchasing power and economic growth in many of Taiwan's trading partners, and Taiwan's exports should benefit from lower oil prices as well. In addition, one side effect of lower oil prices is a higher-valued US dollar. The Taiwanese currency has depreciated about 5 percent against the US dollar since the summer of 2014, boosting the competitiveness of Taiwan's exports in global markets. Thus the overall prospects for exports—especially to countries other than China—are good.

Negative impact of China's slowdown

Next, consider the impact of China's slowdown. China and Hong Kong purchase almost 40 percent of Taiwan's exports. Meanwhile, the United States and European Union account for nearly 20 percent of Taiwan's exports. The Chinese economy has slowed considerably and continues to decelerate. Growth this year is expected to be the lowest in a generation. This is likely to have a chilling effect on the volume of Taiwanese exports to China. Moreover, China remains at risk of financial instability, given its high level of private sector debt, much of the servicing of which depends on investments that are generating negative returns. This sets the stage for potential problems for debtors, and China is the largest external debtor of Taiwanese banks.

Prospects for trade with China

In recent years, the ruling Kuomintang Party (KMT) of Taiwan has worked closely with the mainland to further deepen economic relations. Yet there has lately been a backlash in Taiwan against closer relations with China due to several factors. First, the political events in Hong Kong last year gave pause to those in Taiwan thinking about closer political relations with China. Second, as Taiwanese companies invest in China, there is concern about the loss of high-paying manufacturing jobs in Taiwan. Finally, Taiwan and China signed the Trade in Services Agreement, which many Taiwanese see as increasing Taiwan's dependence on the Chinese economy. One side effect of popular resentment was that the KMT suffered losses in last year's local elections. It will next face the electorate in national elections in 2016. As such, it seems likely that further integration will be placed on hold at least until after the 2016 elections. Yet Taiwan is not in a position to deepen trade relationships with countries other than China because it lacks formal relations with many of the world's largest economies. Consequently, it has not been included in the Trans-Pacific Partnership, a trade agreement being negotiated by the United States, Japan, and nine other Pacific Rim nations. Taiwan's only hope for greater and substantial economic integration is with China.

Longer-term issues

The challenge that Taiwanese leaders face is to continue the shift toward a higher-value-added economy while not completely losing the ability to produce a wide range of goods for the domestic and non-Chinese markets. In a way, Taiwan has come to be for China what Silicon Valley is to the United States: the center of high technology. The country is moving up the value chain, shedding goods production, embracing higher-value-added services, and becoming an affluent society. As this process takes place, Taiwan will see slower but normal rates of economic growth. In 2014, the economy grew 3.7 percent. Going forward, this will likely be at the upper end of the range of growth possibilities. Taiwan is not only becoming a more normal affluent nation; it is also facing some of the demographic challenges common to affluent nations. The working-age population is starting to decline (although this is partly offset by a rise in labor force participation). The solution to demographic constraints is to boost productivity—mainly by investing in higher-value-added processes. Thus integration with China offers a solution, although it is also seen as creating risks.

Endnotes

1. All data in this article come from Oxford Economics, "Country economic forecast, Taiwan," March 2015.

Thailand

Economic recovery depends on internal stability

By Lester Gunnion

2014 was a difficult year for Thailand's economy. Tourist numbers fell due to political tension, manufacturing declined, and private consumption remained subdued. Economic growth for the year on the whole was down to 0.7 percent from 2.9 percent in 2013.

However, a recent rebound in tourism, along with the low price of oil, is expected to initiate an economic recovery. The strength and sustainability of recovery will depend upon how Thailand addresses its problems: high household debt, imminent drought in certain provinces, weakness in Thailand's key export markets (China, Japan, and the European Union), and military rule, which could hurt the prospect of political stability.

Strong Q4 ends year of weak growth

Real GDP grew 2.3 percent year over year in Q4 2014. Government consumption expenditure grew 5.5 percent, picking up from 0.4 percent in Q3. This is in line with the military administration's plan to increase fiscal spending.

However, household consumption expenditure remained weak, decelerating to 1.9 percent from 2.2 percent in Q3. This was mainly because of high household debt and a 1.6 percent contraction in the agricultural sector in Q4. Because approximately 40 percent of Thailand's labor force is employed in agriculture, weak growth in this sector translates into weak consumption expenditure.

Gross fixed capital formation grew 3.2 percent from a year ago. Total investment was driven by private sector investment, which grew 4.1 percent on the back of a recovery in private construction and investment in machinery and equipment. On the other hand, public investment declined 0.3 percent in Q4 even though public construction grew 5.1 percent.

Net exports contributed 3.7 percent to GDP growth in Q4, as external demand resulted in improved exports while imports continued to shrink. The relatively strong performance of the external sector was reflected in manufacturing, which grew 0.7 percent after six consecutive quarters of contraction.

Q4 2014 was the strongest quarter of the fiscal year, but one must keep in perspective the low base of the comparison point: Q4 2013, when the political unrest began. Additionally, the low growth rate of 0.7 percent in 2014 made Thailand the slowest-growing Southeast Asian economy. Furthermore, the problems that plague Thailand's economy are not likely to vanish in the coming quarter.

Slump in consumption

Household debt in Thailand has risen from 60 percent of GDP in 2009 to 85 percent of GDP in 2014. Low interest rates, easy access to credit, and populist schemes such as tax rebates for first-time car buyers have encouraged this trend. The debt-service ratio among farmers is critically high at 52 percent. This means that more than half the disposable income of an indebted Thai farmer is spent on servicing debt payments. Furthermore, the prices of two widely grown crops, rice and rubber, continue to remain low, keeping down incomes in the agriculture sector. Complicating matters further is the looming drought, which is expected to be the worst in a decade. These factors are likely to keep consumption expenditure subdued, particularly among Thailand's rural majority.

Exports unlikely to come to the rescue

The outlook for Thai exports in 2015 is not too bright: The Bank of Thailand forecasts that exports will grow just 0.8 percent in 2015.[1] Several factors contribute to this forecast.

Thailand's main export destinations are not doing particularly well. China's growth rate has slowed as the economy is going through restructuring. Japan remains fragile, and growth in the Eurozone is still weak. The only bright spot is the strengthening US economy, but this is unlikely to outweigh weakness in other major export destinations.

In January, exports to China dipped 19.7 percent from a year ago, while exports to Japan and Europe fell 7.5 percent and 5.0 percent respectively. Furthermore, Thailand is now excluded from the European Union's Generalized System of Preferences because it is now classified as an upper-middle-income country. The European Union has also suspended free-trade talks with the Thai military administration and is unlikely to resume talks before the election of a civilian government, which could be as late as 2016.

The strength of the Thai baht relative to competitor nations' currency is another cause for concern. The baht has appreciated 14 percent against Indonesia's rupiah and 12 percent against the Malaysian ringgit from a year ago (mid-March).

The debt-service ratio among farmers is critically high at 52 percent.

Some bright spots

Low crude oil prices, however, have come as a welcome relief, helping slash Thailand's import bill and keeping net exports positive. Lower energy prices should work to the advantage of the domestic economy by encouraging private consumption. Consumer prices in Thailand declined from a year ago by 0.41 percent in January and by 0.52 percent in February. These figures are well below the lower limit of the Bank of Thailand's (BOT) target range of 1–4 percent for headline inflation in 2015.

Declining prices and weak economic growth resulted in the BOT cutting its policy interest rate in March by 25 basis points to 1.75 percent. This was the first reduction in the policy rate in a year. The accommodative monetary policy should provide respite to highly leveraged households as well as encourage private consumption to pick up.

The recent improvement in the tourism industry is another positive. Tourist arrivals were up 15.9 percent from a year ago in January and 18.0 percent from a year ago in the first half of February.[2] A surge in the number of tourists from China, Thailand's largest group of foreign tourists, has helped to boost the sector.

Factors that drive progress

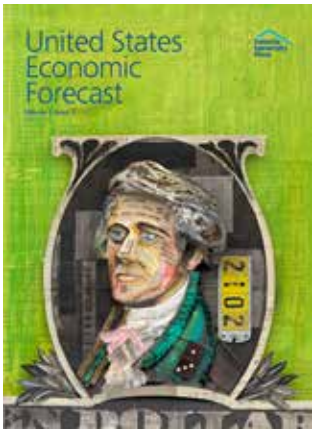
While Thailand has posted a mild recovery from its poor showing in 2014, the near-term performance of the economy will depend to a large extent upon internal stability and the strength of the global economic recovery. In the short run, Thailand is expected to reap the benefits of low oil prices, easy money, and a rise in the number of foreign tourists.

However, long-term growth will depend upon how Thailand addresses its internal problems. A resurgence of political instability will put the brakes on economic growth and cause investors to turn their attention to other destinations in Southeast Asia.

Endnotes

1. Reuters, "Thai central bank cuts 2015 growth, export forecasts," *Business Times*, March 20, 2015, http://www.businesstimes.com.sg/government-economy/thai-central-bank-cuts-2015-growth-export-forecasts.
2. Daniel Lorenzzo, "Thai tourism industry bounced back in 2015," *Thailand Business News,* February 17, 2015, http://www.thailand-business-news.com/news/top-stories/50337-thai-tourism-industry-bounced-back-2015.html.

Additional resources



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