

ASEAN Macro View

Chartbook: Banking on G3 Recovery on Domestic Constraints

- **More open economies to perform marginally better in 2014 on G3 recovery** — ASEAN-5 GDP likely slowed further to 3.9% in 4Q13 (3Q: 5.1%, 2Q: 5.2%). Expected stable growth of 4.8% in 2014F hinges on G3 recovery lifting exports, but less than before, given [1] falling import market shares, [2] US recovery focused on segments less linked to ASEAN, [3] shift towards services imports. Concentration in capital goods in its exports renders TH more vulnerable to ID capex slowdown.
- **Constraints to domestic demand** — While export recovery and FDI diversion from CN should help FDI, elsewhere domestic demand may be constrained by [1] tighter funding conditions with Fed tapering and domestic monetary tightening (especially ID); [2] rising household leverage and debt service ratios constraining consumer spending in MY, SG and TH; [3] fiscal consolidation (esp MY); [4] political impasse in TH delaying implementation of infrastructure and FDI.
- **Could external imbalances improve faster than expected?** — Recent data suggest ID's CAD could fall below 3% of GDP in 4Q, partly reflecting the weaker FX and tighter policy on domestic demand although we maintain our 2014 forecast of 2.7% of GDP (2013E: -3.5%). Fiscal consolidation and modest export recovery should drive a rebound in MY's CA surplus to 4.4% of GDP in 2014F (2013E: 3.8%), with TH (2014F: 0.7%, 2013E: 0.9%) constrained by export under-performance.
- **Divergent inflation and monetary policy outlooks** — Despite an edging-up of inflation on [1] lagged pass through of wage costs (esp SG), [2] FX weakness on import prices (esp ID), and [3] subsidy normalization, only in MY and PH will inflation be a driver of expected rate hikes from 2Q, with risks of delays. BI rate hikes will be driven by CA adjustment imperatives, while BOT could cut 25bps in Jan on below-trend growth and subdued core inflation.
- **Progress of structural reforms determined by the electoral cycle** — Structural reforms in ID may wait till after the new government takes charge, perhaps with a fuel price hike in early 2015. Political uncertainty in TH may not be resolved by early elections in Feb, impeding critical infrastructure investments. With elections still 3-5 years away elsewhere, the bitter medicine of reforms will be frontloaded in 2014F esp. in MY, where fiscal reforms have made material progress in recent months.
- **Relative FX rankings** — Apart from slow CAD adjustment, political risk premia and further rate cuts will weigh on the THB at least near term. While IDR remains vulnerable in a Taper environment, we would not rule out positive surprises in the CAD or elections. SGD is in the middle, with its safe-harbor properties and positive slope of the band offset by negative carry. Improving CA, fiscal, and rate hikes could help MYR though we remain wary of heavy foreign positioning. We like PHP for strong CA dynamics, good growth prospects, and possible rate hikes.

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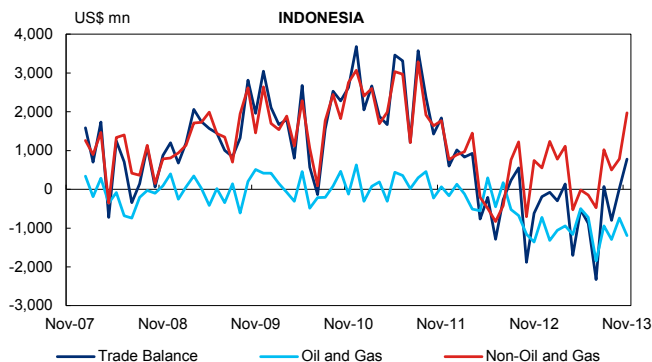
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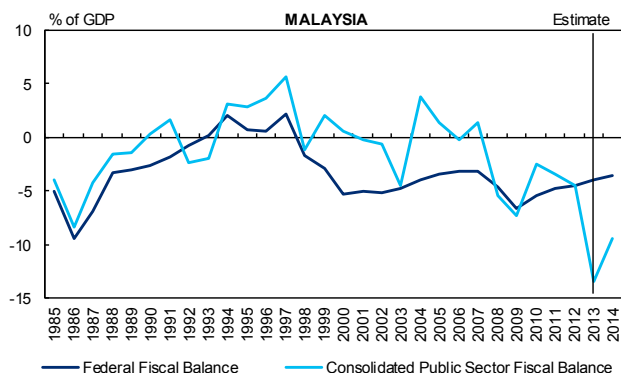
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Figure 1. INDONESIA: Trade balance has started to improve, led by non-oil and gas – stabilizing commodity prices have nudged up exports, while policy adjustments have hit capital goods and raw material imports



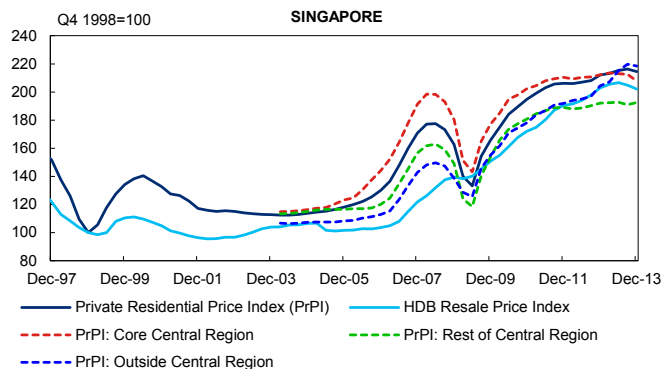
Source: CEIC, Citi Research

Figure 3. MALAYSIA: Fiscal consolidation will likely take a toll on growth



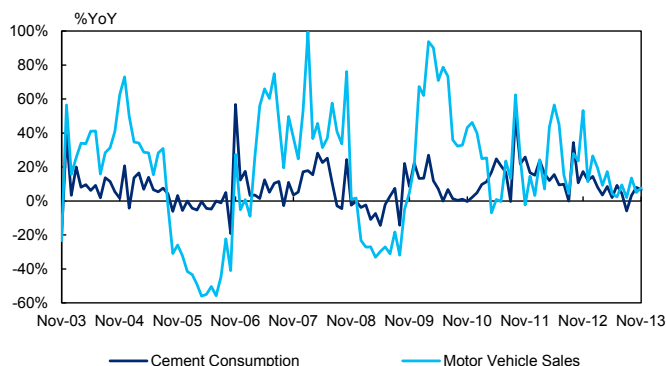
Source: MoF Malaysia, CEIC, Citi Research

Figure 5. SINGAPORE: Private home prices fell in 4Q13 for the first time in seven quarters, led by the Core Central Region



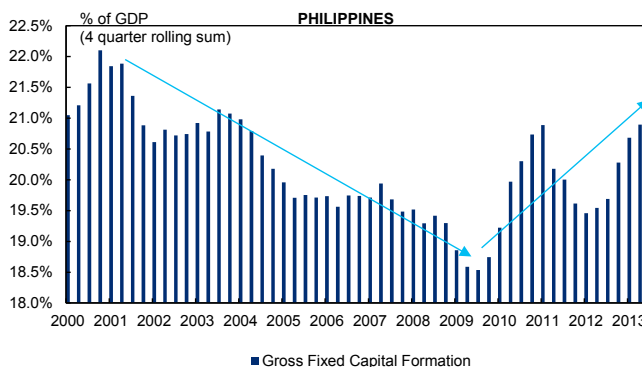
Source: CEIC, URA, Citi Research

Figure 2. INDONESIA: Soft landing? Proxies for growth of high import industries showing gradual deceleration



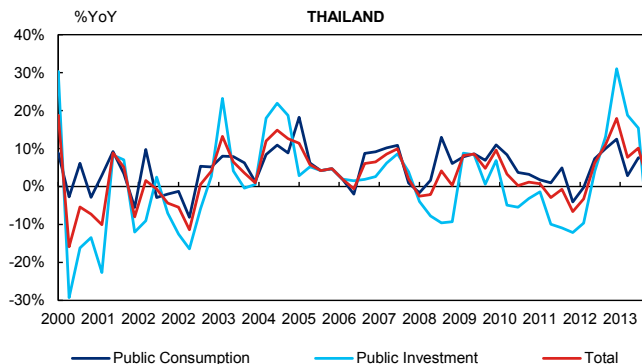
Source: CEIC, Citi Research

Figure 4. PHILIPPINES: Larger real investment contribution to growth under Pres. Aquino's strong governance and infrastructure spending should generate sufficient jobs and incomes



Source: CEIC, Citi Research

Figure 6. THAILAND: The political crisis paralyzes public spending, particularly investments – without strong fiscal spending given the politically polarized environment amid private investments on hold, we expect the growth momentum to ease materially in 1H14



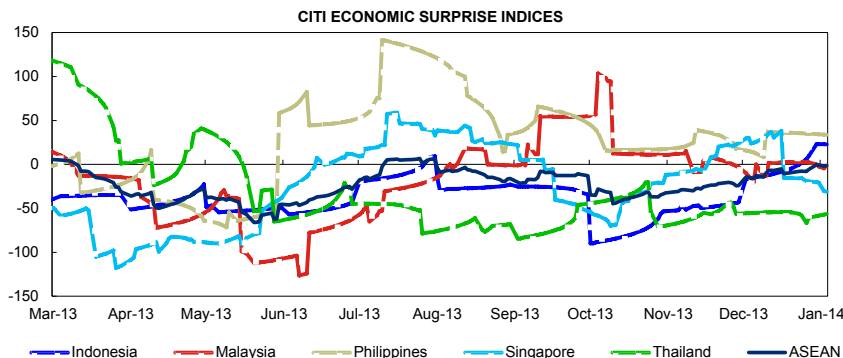
Source: CEIC, Citi Research

As expectations catch up with a more subdued reality, ASEAN-5 economic surprises have turned incrementally less negative since Oct and are on the verge of turning positive in early 2014. While PH has delivered consistent positive ESIs, the biggest improvement has been in ID where inflation and the trade balance have all surprised positively since the start of the year. At the other end of the spectrum, the political crisis and export underperformance has contributed to persistent negative surprises in TH, while SG has seen surprises turn negative on a weaker-than-expected 4Q GDP.

ASEAN-5 growth moderated to 5.1% in 3Q13 (2Q: 5.2%), led by a slowdown in domestic demand in TH as the impact of earlier policy stimulus on consumption began to fade. Partly offsetting weaker domestic demand was a pick-up in net exports, especially in the more open economies of TH, MY and SG. ASEAN-5 growth could moderate further to 3.9% in 4Q on base effects and, in PH, the effects of Typhoon Haiyan on domestic demand. For 2014F, we expect stable growth of 4.8%, but with growth driven more by a recovery in the advanced economies.

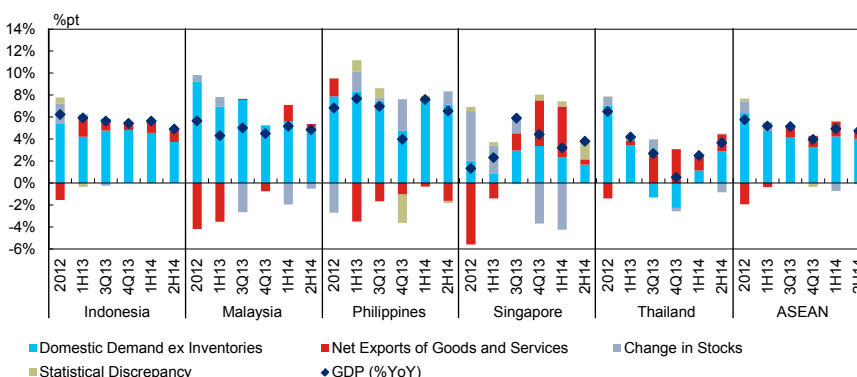
In sequential terms, SG saw the sharpest slowdown. At the other end of the spectrum was MY, which benefited from a strong sequential rebound in net exports. TH's exit from technical recession in 3Q was weaker than expected. Sequential growth profiles will remain uneven across ASEAN in 2014. The interaction between export recovery and domestic demand headwinds should produce patchy expansions in SG and MY, while growth in TH should remain below trend as the political crisis weighs on domestic demand. QoQ growth in PH should rebound in early 2014 after the typhoon-induced weakness in 4Q13.

Figure 7. Citi Economic Surprise Indices

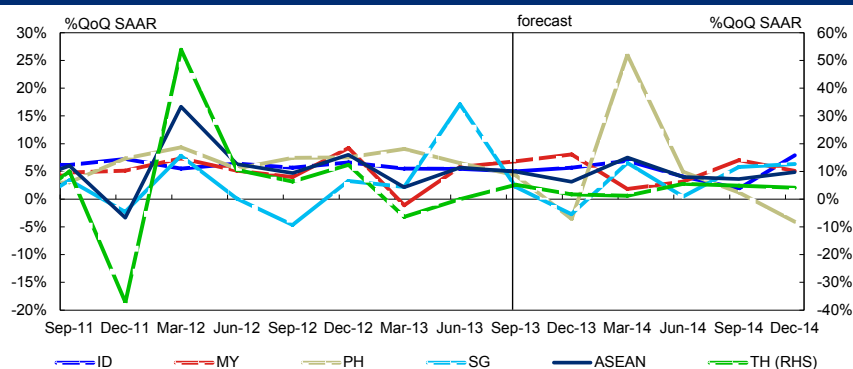


Source: Bloomberg, Citi Research

Figure 8. Contributions to YoY GDP growth



Source: CEIC, Haver, Citi Research Estimates



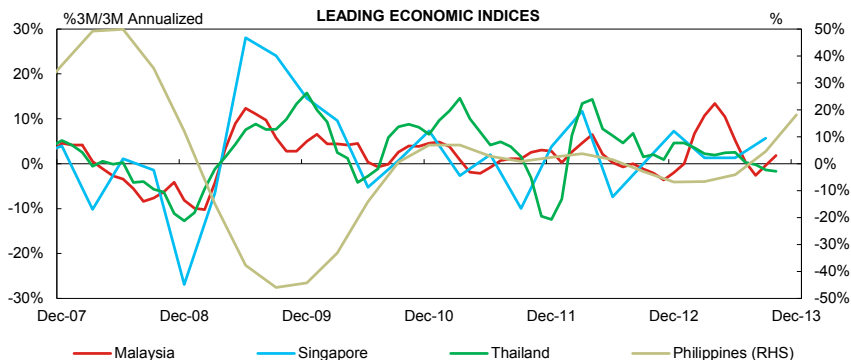
Source: CEIC, Haver, Citi Research Estimates

Available national leading indicators suggest a stronger near-term pick-up in PH, while momentum is likely to stay lackluster in TH and MY near term.

Trade balances in ID, MY and PH – which had seen particularly sharp deterioration early in 2013 – have improved significantly in 4Q. ID for example has seen two consecutive months of trade surpluses, led by the non-oil and gas balance reaching a 26-month high due to a rebound in coal and palm oil exports, as well as a decline in raw material imports.

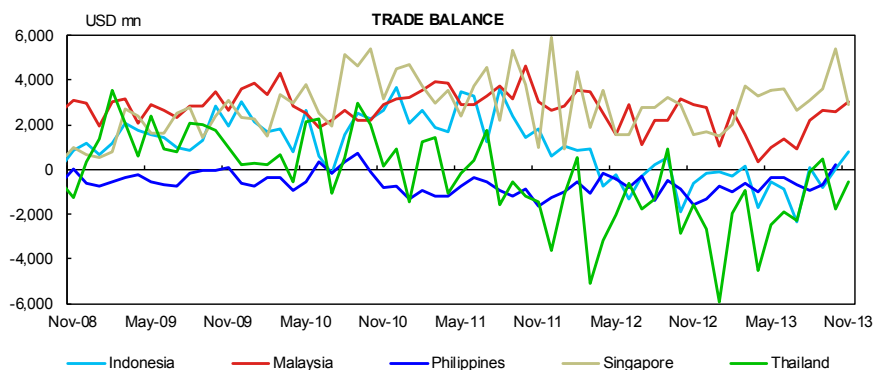
Following stabilization and some rebound in ASEAN-5 exports in Aug-Oct, exports appeared to have ended 2013 close to levels at the start of the year.

Figure 9. Leading Economic Indices and Indicators



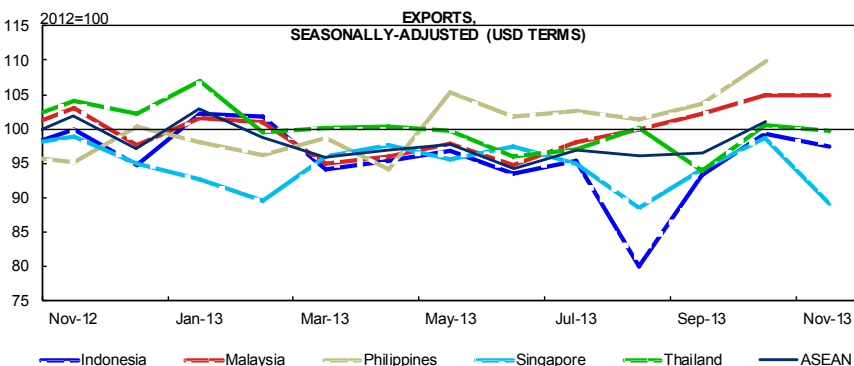
Source: CEIC, Citi Research

Figure 10. Merchandise Trade Balance



Source: CEIC, Citi Research

Figure 11. Export Levels, Seasonally-Adjusted



Note: We use NODX for Singapore.

Source: CEIC, Citi Research

Tech leading indicators entered 4Q13 on a strong note, with all 10 leading indicators rebounding in Nov, with the semiconductor book-to-bill ratio rising above 1.

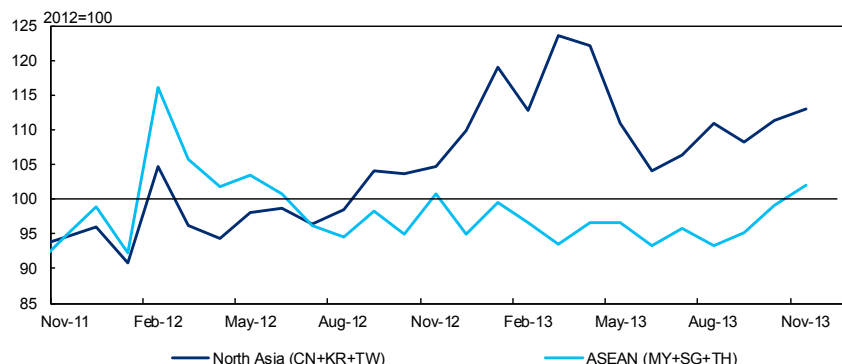
Figure 12. Indicators of Electronics Demand

	US New Orders for Computers and Electronic Products	PPI for Semicon & Related Device Mfg	US Shipment to Inventories Ratio for Computers and Electronic Products	US ISM Mfg PMI	US NASDAQ	US Semicon Book-to-Bill Ratio	Taiwan Electronics Products Export Orders	Taiwan Information and Communication Products Export Orders	Singapore Electronics New Export Orders PMI	NY Fed Empire State Mfg Survey: Future Tech Spending	Number of Categories Rising Sequentially
	USD mn, SA	Dec-98=100			2/5/71=100		2006=100, SA	2006=100, SA			
Apr-13	21,541	39.4	0.598	50.7	3,328.79	1.08	101.7	102.8	53.1	12.5	6
May-13	22,236	39.8	0.585	49.0	3,455.91	1.08	101.3	102.9	53.3	11.4	5
Jun-13	22,069	39.8	0.588	50.9	3,403.25	1.10	103.9	104.1	51.7	-3.2	5
Jul-13	21,460	39.8	0.584	55.4	3,626.37	1.00	104.7	104.4	51.3	10.9	4
Aug-13	20,470	39.7	0.598	55.7	3,589.87	0.98	106.7	106.5	54.0	4.8	5
Sep-13	21,499	39.5	0.596	56.2	3,771.48	0.97	108.8	116.0	51.7	11.8	6
Oct-13	22,007	39.5	0.588	56.4	3,919.71	1.05	113.2	111.1	52.2	12.1	7
Nov-13	22,389	39.7	0.594	57.3	4,059.89	1.11	116.3	117.6	52.6	13.2	10
Dec-13				57.0	4,176.59				51.8	10.8	1

Source: Haver, CEIC, Citi Research

Tech exports in ASEAN continue to underperform North Asia but the gap is closing, led by a pick-up in MY tech exports.

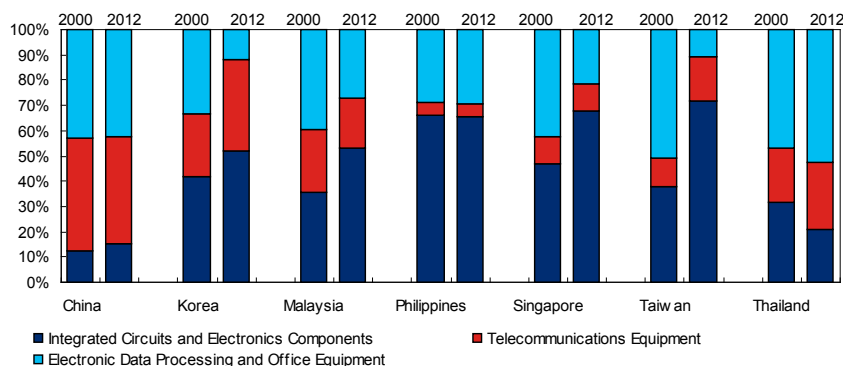
Figure 13. Tech Export Levels, Seasonally-Adjusted



Source: CEIC, Citi Research

Tech underperformance partly reflects exposure to PC-related final demand in ASEAN tech exports vs KR and TW.

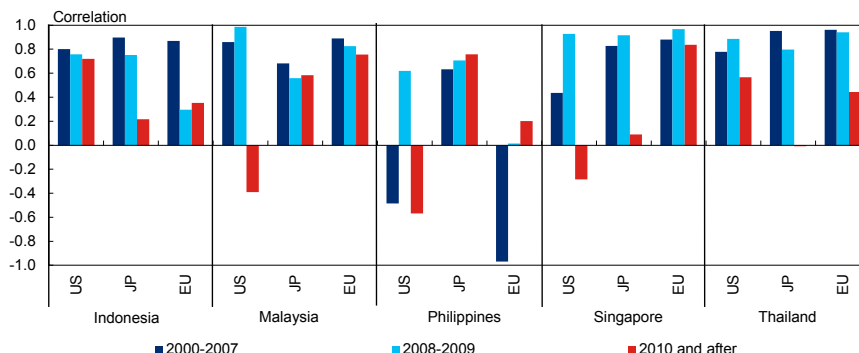
Figure 14. Composition of Tech Exports



Source: WTO, Citi Research

ASEAN-5 exports have become increasingly less positively correlated with G3 domestic demand since 2010. Indeed, correlations have turned *negative* in a number of cases, e.g. MY, PH and SG exports with US domestic demand. The fall appears less pronounced for exports to Europe. This suggests that a rebound in G3 demand – especially the US – may not translate into as strong a rebound in ASEAN exports as compared to the early 2000s.

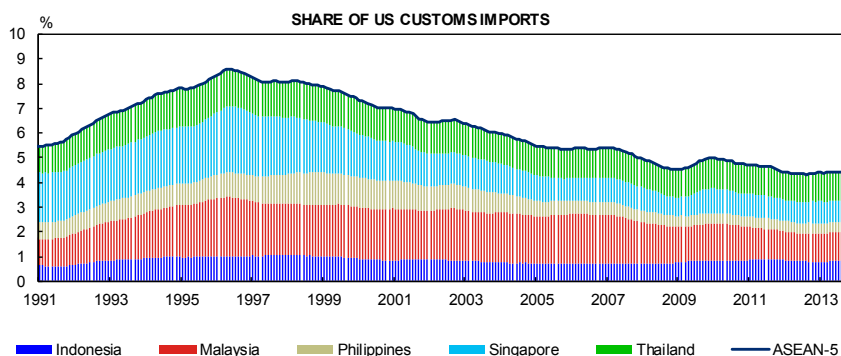
Figure 15. ASEAN export sensitivity to G3 real domestic demand (ex inventories)



Source: CEIC, Citi Research

One reason for the falling sensitivity to G3 demand is that ASEAN has been losing import market share in the G3 economies. This is especially the case for the US, where ASEAN-5's share of US customs imports has fallen dramatically from >8% in 1997 to just 5% today, partly reflecting the relocation of export production to CN. The biggest declines were seen in SG and PH (where market share losses were front loaded in the early 2000s) and MY (where market share declines were more recent since 2010).

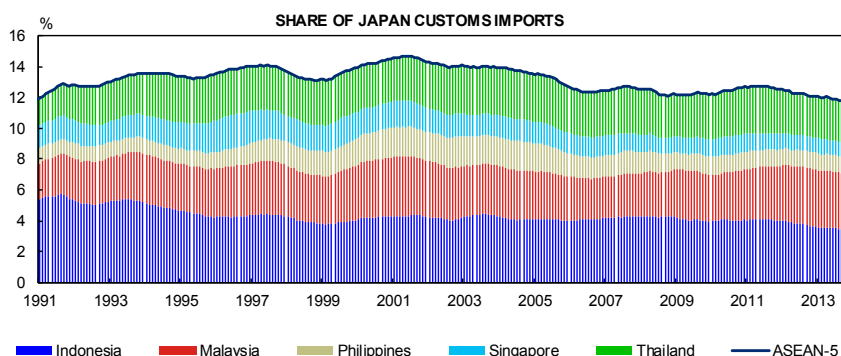
Figure 16. ASEAN share of US customs imports



Source: Citi Research

The loss of import market in JP has been less dramatic for most ASEAN countries, with SG and PH suffering the biggest losses since the early 2000s and market share losses only seen more recently for ID and TH. In fact, MY has seen a gain in market share since 2011, as the Mar-2011 earthquake triggered a rise in demand for LNG imports from MY.

Figure 17. ASEAN share of Japan customs imports



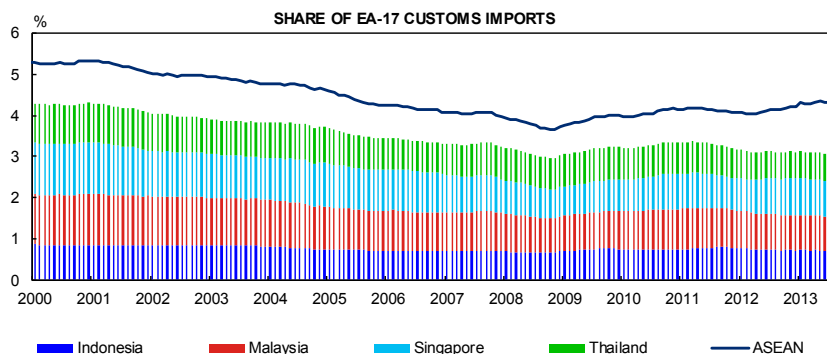
Source: CEIC, Citi Research

With respect to import market share in the EU, the record appears mixed. While MY, ID, and TH appear to have lost some market share, SG has seen its market share stabilize, partly reflecting the dominance of pharmaceuticals in exports to EU (which are less related to macroeconomic factors). Although data for PH is not published separately, ASEAN-wide data suggest market share gains by the smaller economies, which would also include imports from other CMLV countries.

Another reason for reduced export sensitivity to G3 demand is that technological innovations may have shifted G3 demand away from traditional goods imports towards services, e.g. shift from physical to digital content. Fortunately, except for ID, most ASEAN countries have been able to successfully penetrate the US market for services imports (especially in Business Professional and Technical Services imports). That said, this mitigating factor should not be exaggerated, as US services imports are just one-fifth of goods imports

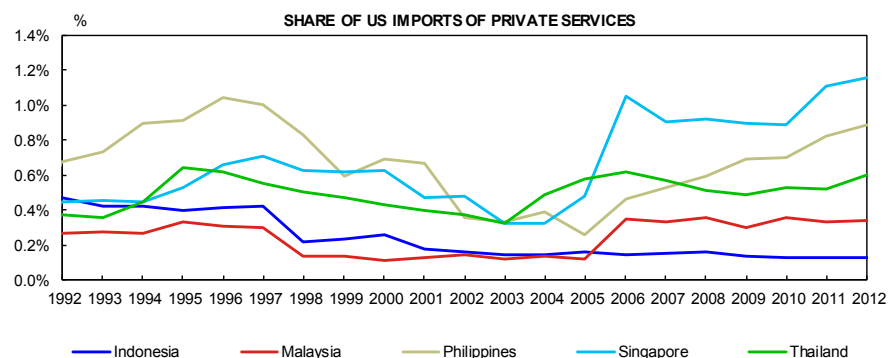
Moreover, focusing exclusively on services exports to the US may fail to convey the full impact on growth. Given the two-way trade in services, many ASEAN countries remain significant net importers of private business, professional and technical services from the US. In fact, Singapore's trade deficit in such services from the US has widened, despite Singapore gaining share in the US import market. Only PH has seen a significant improvement in its services trade balance vis-à-vis the US.

Figure 18. ASEAN share of EA-17 customs imports



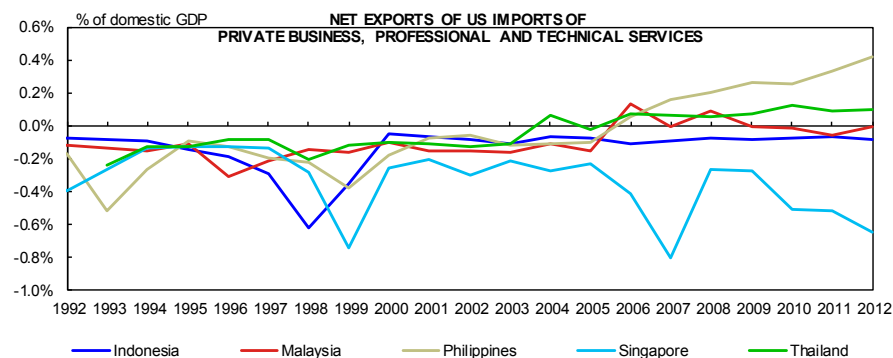
Source: CEIC, Citi Research

Figure 19. ASEAN Share of US Imports of Private Services



Source: CEIC, Citi Research

Figure 20. ASEAN Net Exports of Private Services: Business, Professional, and Technical Services to US



Source: CEIC, Citi Research

A final reason for reduced sensitivity is that the G3 recovery so far has been narrowly based in segments less sensitive to imports from ASEAN. Real US-bound exports of ASEAN countries have historically been much more sensitive to a 1%pt rise in US tech capex spending, as opposed to a similar rise in tech consumer spending. This may be because ASEAN tech exports remain much more linked to PC-related end demand, as opposed to smartphone demand. The *negative* beta of MY and PH may be because US import market-share losses from production relocation of tech firms over the past decade overwhelmed any lift from US tech demand.

An external imbalance-induced growth slowdown in ID could have spillovers on other ASEAN countries, including those not facing CA pressures.

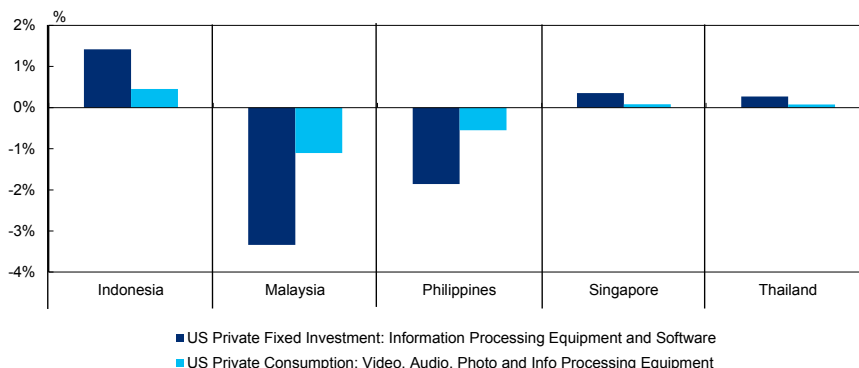
SG appears the most vulnerable to a growth slowdown in ID, especially if refined oil exports to ID shrink. So far, oil exports have been resilient, but non-oil exports have been hit. Similarly, MY's rising export exposure reflects mainly the resilience of refined oil exports to ID.

TH's export exposure is almost as large as MY but has shrunk, reflecting the reduction in ID's non-oil imports, while PH appears the most insulated to a trade shock from ID.

TH appears comparatively more exposed to an investment slowdown in ID, as almost half of its exports to ID are in capital goods (largely transport equipment, other machinery, and electrical goods).

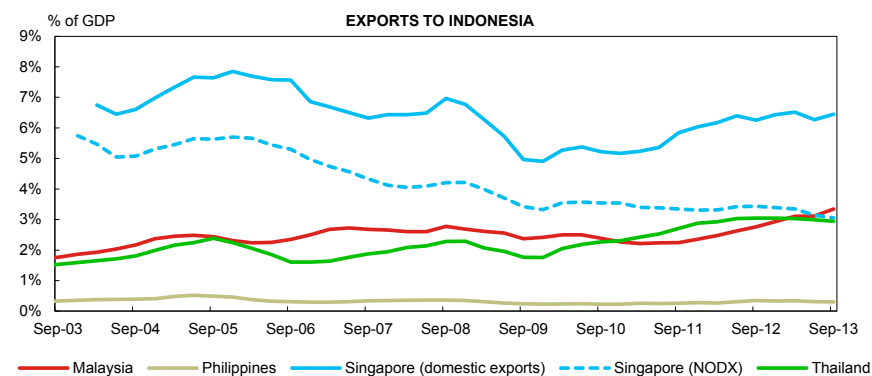
For MY, the impact would be felt largely via a slowdown in intermediate imports used for domestic demand, especially refined petroleum products to ID, particularly as the impact of lower fuel subsidies in ID starts to bite.

Figure 21. ASEAN US-bound export sensitivity to US GDP



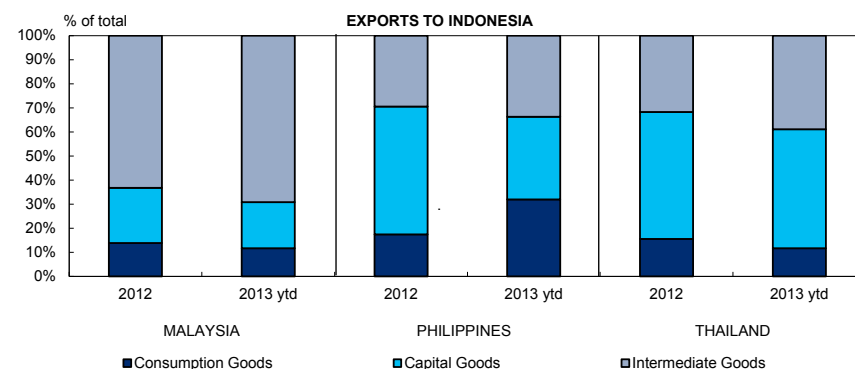
Source: CEIC, Citi Research

Figure 22. Exports to Indonesia



Source: CEIC, Citi Research

Figure 23. Estimated Decomposition of Exports to Indonesia by End Use



Source: CEIC, Citi Research Estimates

Besides the merchandise trade channel, a slowdown in ID would adversely impact ASEAN economies via the services trade channel, including financial services, transport, and tourism flows. Of these, the impact via the tourism channel is easiest to quantify. With ID its largest source of tourists (19% of visitor arrivals), SG appears most vulnerable from this channel (though small at just 0.8% of GDP), followed by MY and TH.

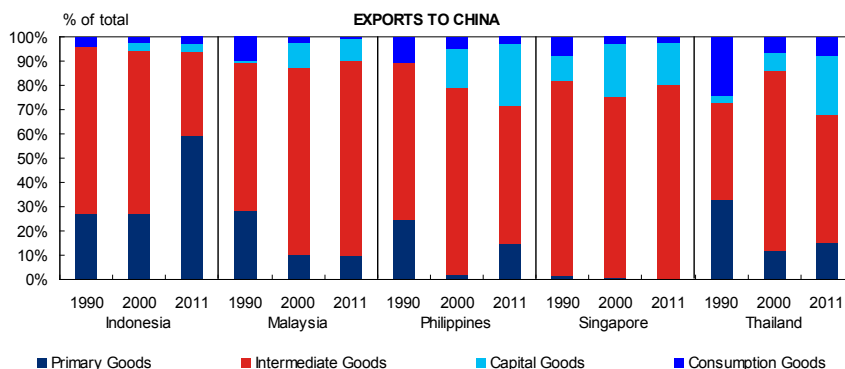
Figure 24. Estimated Real GDP Exposure to Indonesian and Chinese Tourist Spending



Note: We estimate nominal Indonesian tourist spending and deflate to constant prices to obtain real GDP exposure.
Source: CEIC, Citi Research Estimates

A more recent and granular analysis data from the Japan-based RIETI suggests an even heavier emphasis on intermediate goods exports to CN, especially for SG and MY, where the intermediate goods share is around 70-80% of total exports – these are mostly used to supply China's export engine rather than its domestic demand. Our estimates based on the RIETI estimates suggest that only 31% of ASEAN exports to China are for its domestic demand.

Figure 25. Exports to CN by end use (RIETI Estimates)



Source: RIETI (<http://www.rieti.go.jp>), Citi Research

Provided the slowdown in ID and CN is modest, the impact via the trade channel on GDP growth should still be offset by a modest pick-up in demand from G3, as exports to the G3 (taking into account indirect exports via CN, proxy using intermediate goods exports to CN) are between 2-7 times larger than exports to CN and ID.

We note that SG's large headline exposure to EU final demand as % of GDP masks the fact that around half of NODX to EU is in pharmaceuticals not closely tied to the economic cycle. Stripping out pharma exports to EU, final demand exposure to G3 would be still be twice that of CN and ID combined.

The investment share of GDP in ASEAN is likely to show mixed trends across ASEAN in 2014. The sharpest increases are likely in MY and PH – the latter largely reflecting the “crowding in” from public infrastructure investments, while the former a mixture of public infrastructure projects and manufacturing/ commodities-related FDI. In contrast, investment share of GDP is likely to fall in ID and TH – the former on over-capacity especially in commodity-related sectors and the latter due to political uncertainty hurting public investments and FDI implementation.

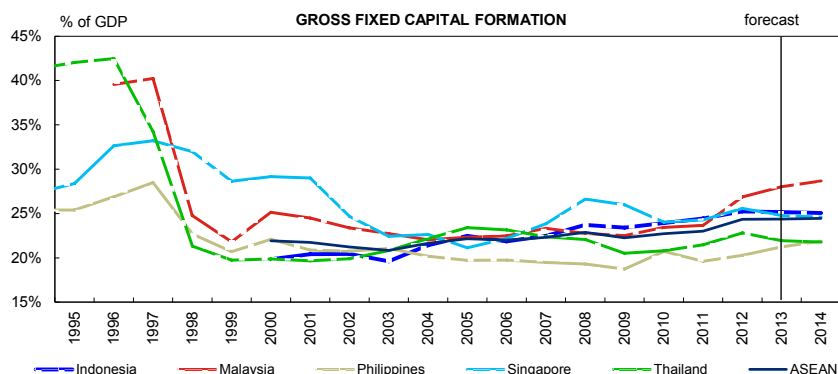
Figure 26. The exposure of Malaysia's direct exports to China and Indonesia is substantial – but Malaysia's vulnerability may be exaggerated once indirect exports to the developed markets via China are taken into account

% of GDP	ID	MY	PH	SG NODX	SG DX	TH
Direct Exports to US	1.7	6.1	2.8	4.3	4.8	5.8
Direct Exports to EU	1.6	6.5	2.2	5.8	7.5	5.0
Direct Exports to Japan	3.1	8.2	3.9	2.9	3.1	5.7
Direct Exports to Indonesia		3.3	0.3	3.1	6.4	2.9
Direct Exports to China	2.5	9.4	2.2	6.2	8.4	6.7
Exports to China for Processing (% exports to China)	34.6	80.0	57.3	80.0	80.0	52.2
Exports to China for Domestic Dd (% exports to China)	65.4	20.0	42.7	20.0	20.0	49.9
Exports to China used for Domestic Demand		1.6	1.9	1.0	1.2	3.3
China's Exports to US (% of China's exports)	16.6	16.6	16.6	16.6	16.6	16.6
Indirect Exports to US via China	0.1	1.2	0.2	0.8	1.1	0.6
Total Direct and Indirect Exports to US	1.9	7.3	3.0	5.2	5.9	6.4
China's Exports to EU (% of China's exports)	15.2	15.2	15.2	15.2	15.2	15.2
Indirect Exports to EU via China	0.1	1.1	0.2	0.8	1.0	0.5
Total Direct and Indirect Exports to EU	1.7	7.7	2.4	6.6	8.6	5.6
China's Exports to Japan (% of China's exports)	6.9	6.9	6.9	6.9	6.9	6.9
Indirect Exports to Japan via China	0.1	0.5	0.1	0.3	0.5	0.2
Total Direct and Indirect Exports to Japan	3.1	8.7	4.0	3.2	3.6	6.0
Total Direct and Indirect Exports to G3	6.7	23.7	9.4	15.0	18.0	17.9
Exports to ID and China for Domestic Demand		5.2	1.3	4.3	8.1	6.3

Note: Estimates are based on four quarters up to 3Q13.

Source: RIETI, CEIC, Citi Research

Figure 27. Gross Fixed Capital Formation as % of GDP



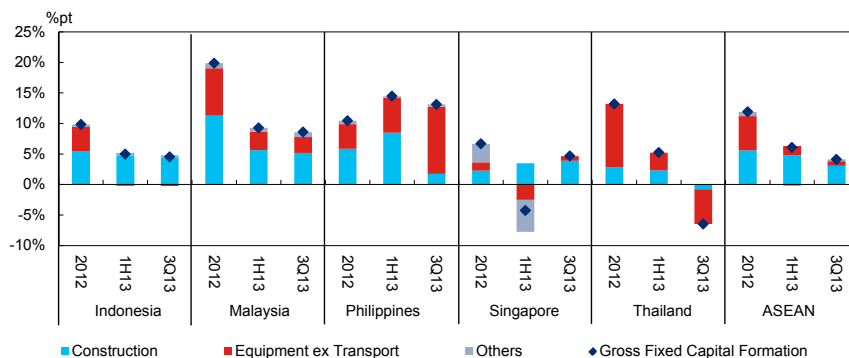
Source: CEIC, Haver, Citi Research Estimates

Except for SG, fixed investment growth continued to soften noticeably through 3Q in most of ASEAN. But unlike in 2Q, this largely reflected a slowdown in construction activities, i.e. non-tradables investments, related to domestic end-demand and the correction of external imbalances. In contrast, machinery and equipment (M&E) investments recovered in most countries – possibly a lagged response to expectations of improving external demand which in turned lifted manufacturing FDI. Only in TH did we see a sharp slowdown in M&E investments, possibly because the political crisis may have delayed the disbursal of previously approved FDI.

Into 3Q13, FDI realization remained robust, particularly in ID (but not sufficient to finance the CA deficit). Whilst FDI approvals remain robust in TH, implementation could be another matter as the ongoing political crisis hurts investor confidence. FDI approvals in PH have been picking up from a low base as cost competitiveness has improved. In SG, FDI has slowed as cost competitiveness has been eroded by restructuring and real exchange rate appreciation.

A major factor driving FDI inflows into ASEAN has been Japan. Japanese ODI into ASEAN-4 (ex SG) has overtaken that into China since 2Q13, reflecting ODI diversification away from China in the wake of bilateral tensions and ASEAN's improving cost competitiveness. Interestingly, even FDI into SG, which had previously slowed on cost competitiveness concerns, has now converged with that into China.

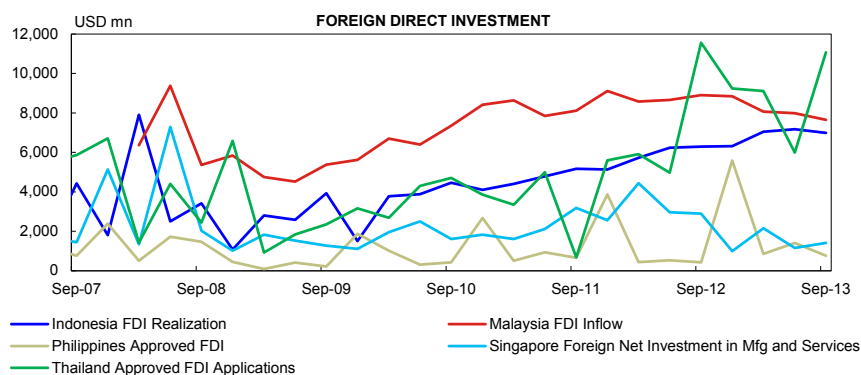
Figure 28. ASEAN Gross Fixed Capital Formation



Source: Note: As far as possible we try to exclude Transport Equipment from the Equipment category. Included in the Equipment category are Machine and Equipment (excludes Transport) for Indonesia; Machinery and Equipment (includes Transport) for Malaysia; Durable Equipment (includes Transport) for Philippines; Machinery, Equipment and Software (excludes Transport) for Singapore; and Equipment (includes Transport) for Thailand.

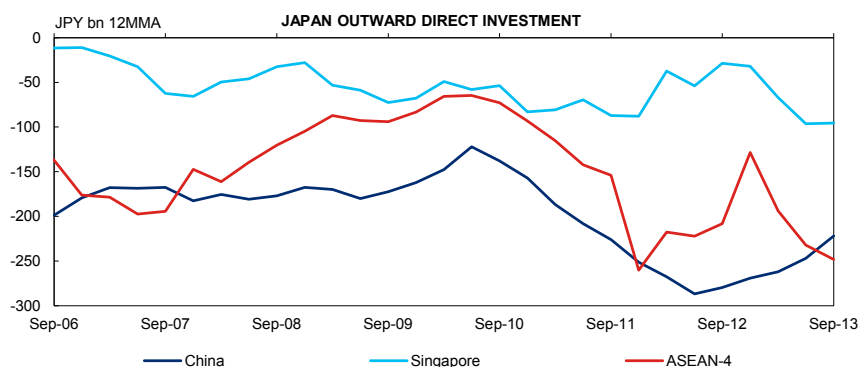
Source: CEIC, Citi Research

Figure 29. Foreign Direct Investments Approvals and Realization



Source: CEIC, Haver, Citi Research

Figure 30. Japan Outward Direct Investment by Destination

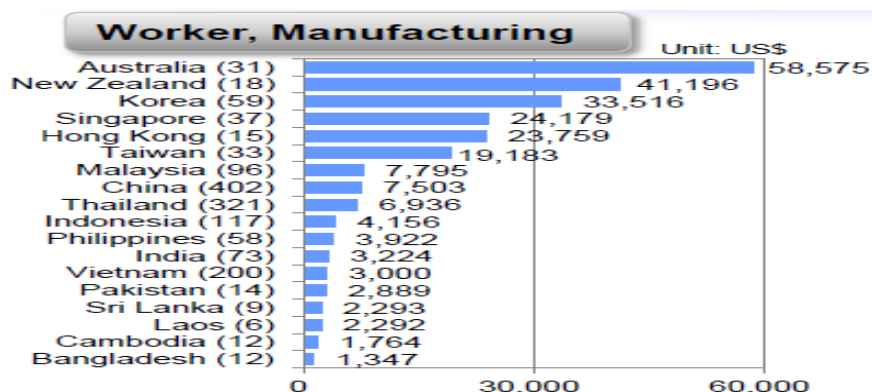


Note: A larger negative figure indicates a larger flow of direct investments out of Japan

Source: CEIC, Citi Research

While comparable or lower manufacturing wages in ASEAN (ex SG) vs CN remain an important reason attracting Japanese FDI into ASEAN...

Figure 31. JETRO Survey of Japanese-Affiliated Companies in Asia and Oceania (FY2013 Survey): Annual Salary

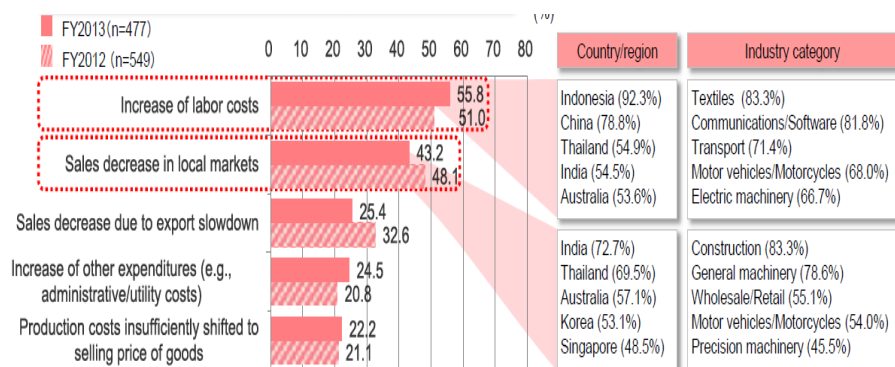


Note: Numbers in parentheses indicate numbers of Japanese firms responding to the JETRO survey. Annual salary includes benefits, social security, overtime allowances, and bonuses, but excludes severance benefits.

Source: JETRO

...increase in labour costs are a major reason for an expected decline in operating profit in 2014, especially in Indonesia and Thailand.

Figure 32. JETRO Survey of Japanese-Affiliated Companies in Asia and Oceania (FY2013 Survey): Reasons for Decreased Operating Forecast for 2014

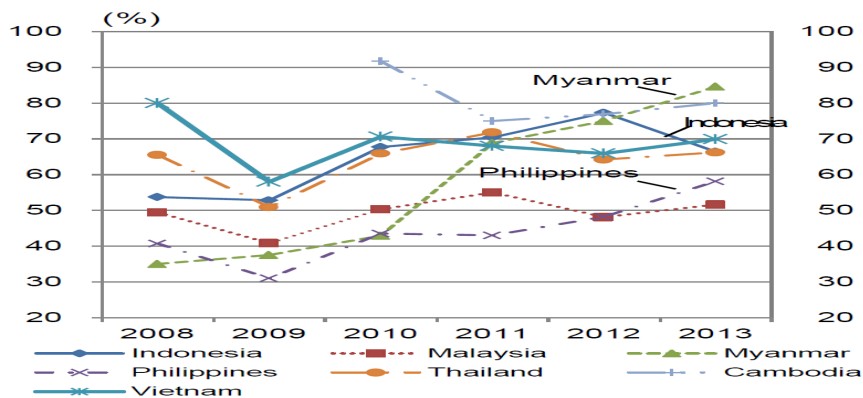


Note: Countries/regions and industry categories for which n≥10

Source: JETRO

Thus surveys of business plans in the 1-2 years show comparatively fewer Japanese firms intending to expand in ID in the next 1-2 years (vs 2012), while the proportion of firms intending to expand in PH is picking up from a low base.

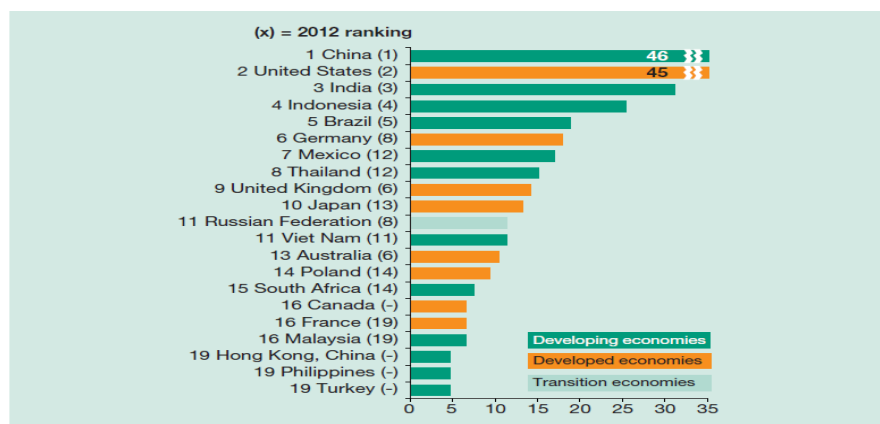
Figure 33. JETRO Survey of Japanese-Affiliated Companies in Asia and Oceania (FY2013 Survey): Proportion of Firms Expecting to Expand in Next 1-2 Years



Source: JETRO

Notwithstanding near-term cyclical weakness and cost increases, surveys of transnational corporations by UNCTAD still reveal all ASEAN-4 economies falling amongst the top 20 FDI host destinations in 2013-2015.

Figure 34. Transnational corporations' top prospective host economies for 2013-2015
(Percentage of respondents selecting economy as top destination)

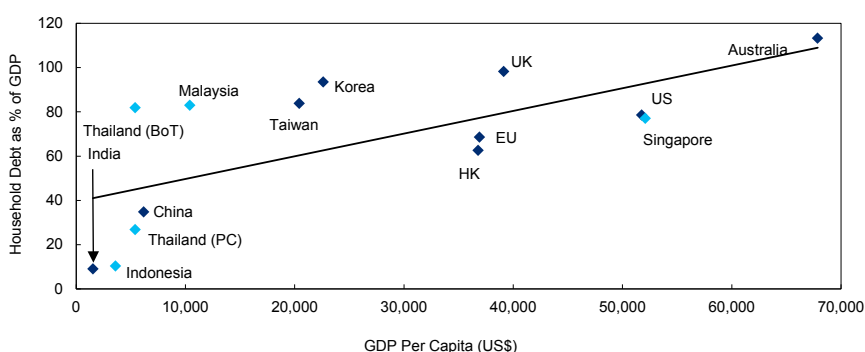


Note: Based on 159 company responses.

Source: UNCTAD survey

In MY and TH, the stock of household (HH) debt is large relative to per capita incomes, in turn suggesting higher debt service burdens relative to household incomes, especially if interest rates rise. Debt service ratios in MY for example are as high as 43% of gross income. TH HH debt-service ratios are in excess of 30%, and would be 20-30% lower if business loans (see [Thailand Banks - Household Debt: Not as Bad as Feared](#)). While aggregate debt ratios do not seem stretched, selected segments of households may have over-leveraged for consumption and housing and thus may have to retrench spending when rates rise (or even before).

Figure 35. Citi Household Debt Estimates vs GDP per Capita

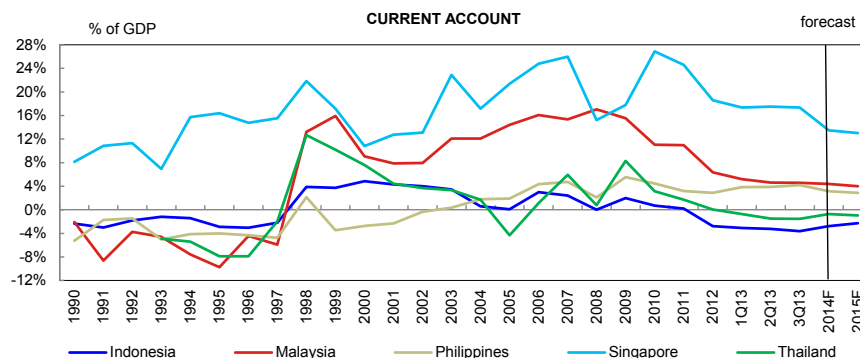


Note: Thailand (BoT) uses the BoT definition while Thailand (PC) excludes business loans to households. We proxy household debt with Financial Institutions' Loans to Households for China, Scheduled Commercial Banks' Personal Loans for India, and Commercial and Rural Banks' Loans for Household Consumption for Indonesia.

Source: CEIC, Haver, MAS, Citi Research

We see a gradual stabilization/improvement in CA positions among the "problem" countries. While recent positive surprises in the ID trade balance suggest a better 4Q13 CA, we maintain our CAD forecast for ID in 2014F of 2.7% of GDP (2013E: -3.5%) given lack of clarity in the implementation of the mineral export ban, the unrestrained oil trade deficit, and a possible temporary rebound in raw material imports as election campaign spending intensifies – though positive surprises are possible partly reflecting the weaker FX and tighter policy on domestic demand on the non-oil trade balance.

Figure 36. Current Account



Note: Data is annual except for 1Q13, 2Q13 and 3Q13 where we use 4-quarter rolling sums.

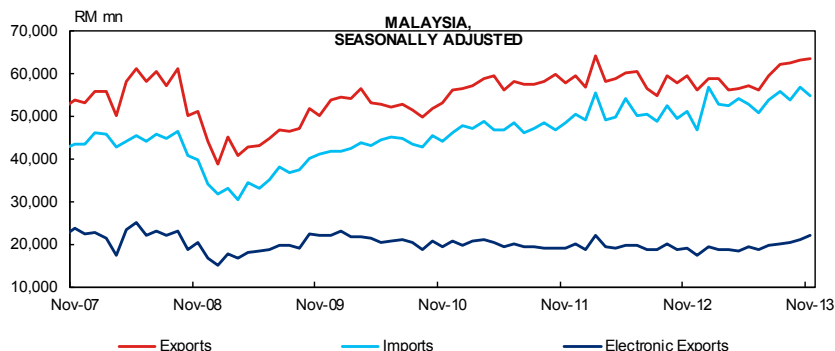
Source: CEIC, Haver, Citi Research

Similarly, fiscal consolidation and modest export recovery should drive a rebound in MY's CA surplus to 4.4% of GDP in 2014F (2013E: 3.7%), with improvement in TH (2014F: 0.7%, 2013E: 0.9%) constrained by comparatively weak export performance. Unlike TH and ID, where trade surplus improvements have been driven largely by import compression, CA improvement in MY also reflects an export improvement, including a turnaround in electronics exports.

With Malaysia's average Oct-Nov trade surplus of RM9.0bn higher than the 3Q monthly average of RM6.2bn, the 4Q CA surplus could surprise on the upside at 6% of GDP (3Q: 4.0%), which should bring the full year 2013 CA surplus to 3.8% of GDP (2014F: 4.4%).

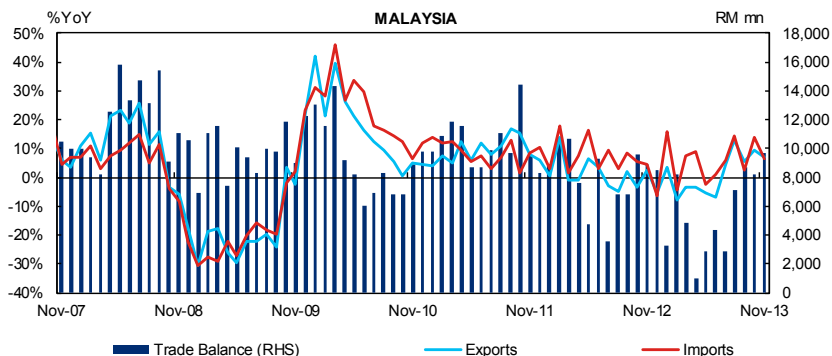
A CA deterioration is less worrying if it finances new investments rather than consumption (which reduces savings). To the extent that ID and MY have seen a fall in national savings rates, their recent deterioration in the CA position is likely more worrisome than TH. Into 2014F and 2015F, the smaller CAD we expect in ID and TH will be largely driven by lower investment to GDP ratios, which suggests a larger toll on growth from the external imbalance adjustment. In contrast, the improvement in MY reflects largely an increase in savings rates – largely on better export earnings, fiscal consolidation, and slower private consumption even as investments rise.

Figure 37. Malaysia Seasonally-adjusted Trade



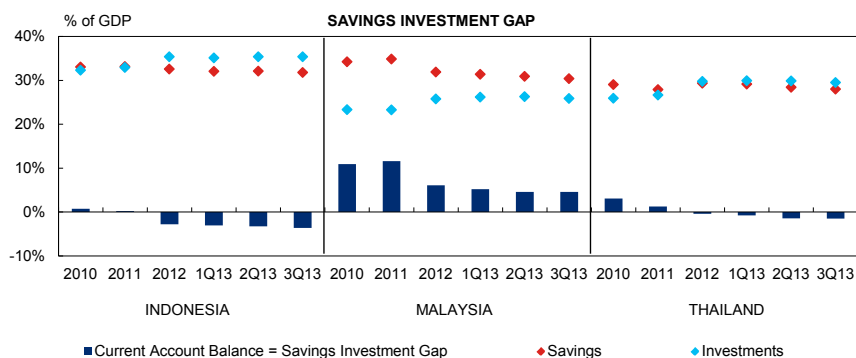
Source: CEIC, Citi Research

Figure 38. Malaysia Trade Balance



Source: CEIC, Citi Research

Figure 39. Savings-Investment Gap: Indonesia, Malaysia and Thailand



Note: We calculate the savings rate implied by investments and current account balances. Data is quarterly on a 4-quarter rolling sum basis. Source: Source: CEIC, Citi Research Estimates

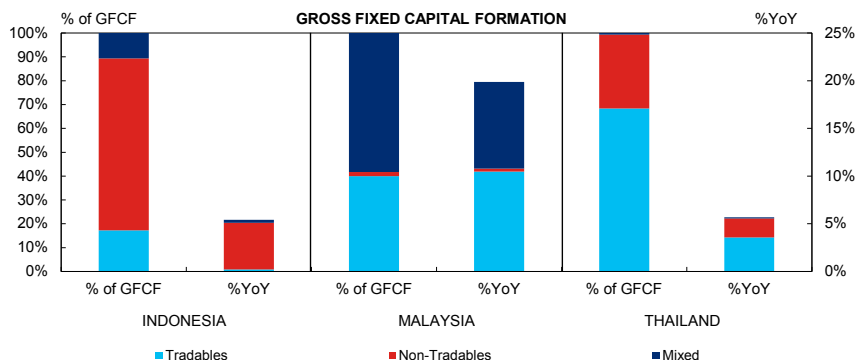
A CA deficit would also be less worrying if driven by investments in tradables sectors, which would ultimately generate export earnings in the future. Tradables sectors appear to play a more important role in MY and especially TH, but investments in ID have been concentrated in non-tradable building/construction activity.

That said, 70% of "building" investments in ID comprise civil infrastructure, including roads, ports and "special construction", e.g. telecom towers and power plants, which could indirectly lift the productivity of the tradables sectors.

To gauge the relative impact of QE on the real economy, we scale cumulative portfolio inflows since the start of QE1 in late 2008 to cumulative domestic demand during that period and find MY more vulnerable. But since MY runs a CA surplus, it can offset foreign capital outflows with domestic savings. To adjust for this, we scale cumulative portfolio inflows against projected CA flows. CA surplus countries MY and PH would require 21% and 56% of cumulative portfolio inflows respectively to reverse before they suffer net external liquidity drains.

As discussed in [Emerging Markets Macro and Strategy Outlook - Prospects for 2014](#), another impact may be a reversal of bank-related inflows when the Fed hikes. Using the data on the change in international claims of BIS banks on both banks and non-bank private corporates, we can again scale this by cumulative real domestic demand of the past five years and by CA balances. Again these bank inflows are largest for Malaysia relative to the size of domestic demand, followed by Thailand, and smallest for PH. Scaling against CA positions, we find that projected current account surpluses in MY and PH in 2014F are 70% and 113% of the change in BIS claims, suggesting more than enough buffer to absorb a reversal of bank inflows.

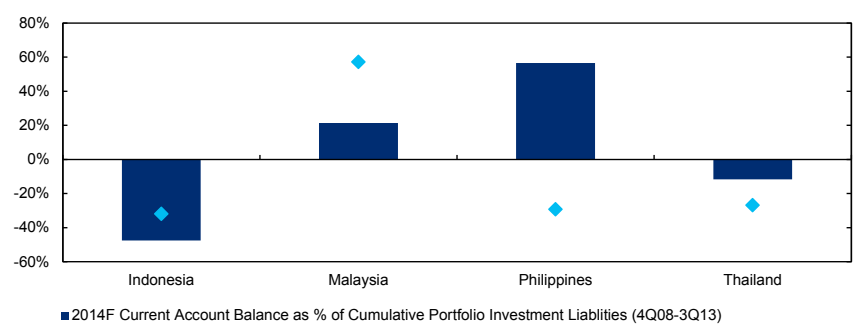
Figure 40. % of Overall GFCF levels and Growth from Tradables



Note: For Indonesia, we classify GFCF in Machinery and Equipment as Tradables, Building as Non-Tradables, and Transportation and Others as Mixed. For Malaysia, we classify Mining and Manufacturing as Tradables, Construction as Non-Tradables, and Agriculture and Services as Mixed. For Thailand, we classify Manufacturing as Tradables; Construction as Non-Tradables; and Business Services, Agriculture, and Mining as Mixed.

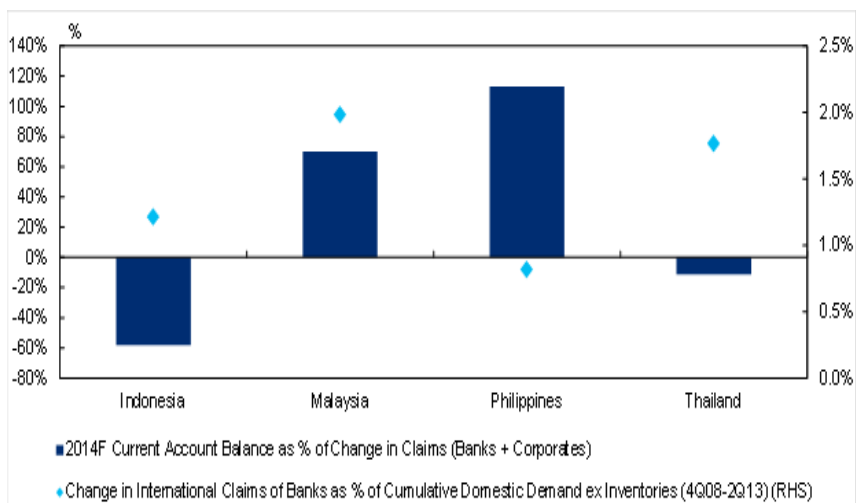
Source: CEIC, Citi Research Estimates

Figure 41. Cumulative Portfolio Investment Liabilities (4Q08-3Q13)



Source: CEIC, Citi Research Estimates

Figure 42. Change in International Claims of Banks (4Q08-2Q13)



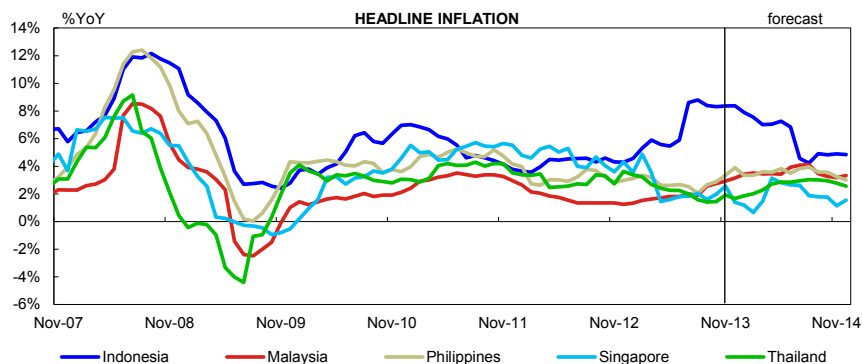
Source: Haver, CEIC, Citi Research Estimates

Headline inflation should stabilize or edge up in 2014, except in ID on base effects post the Jun 2013 fuel price hikes. This reflects [1] lagged impact and second-round effects of subsidy cuts especially in MY (at year end); [2] lagged impact of FX weakness on imported inflation; and [3] lingering wage pressures on core inflation (especially SG).

FX weakness since June has limited the disinflationary impact of lower commodity prices on import prices. Import prices in SG and TH appear to have bottomed, though import prices in MY have yet to feel the impact of MYR weakness. In ID, import prices of key raw materials from China have surged while recent CPI data provide evidence of pass-through via LPG prices.

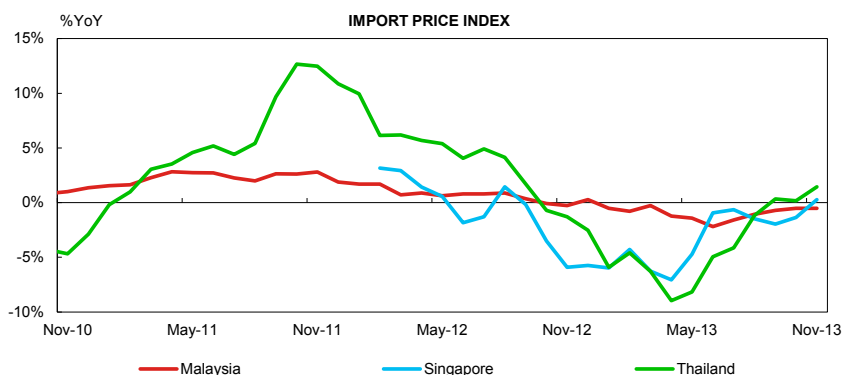
The narrowing negative spread between PPI and CPI inflation indicates that while companies still have some buffer to cushion profit margins against cost increases, this buffer may be gradually eroding, especially in MY and SG, as margins could come under increasing pressure from cost normalization – labour costs in the case of SG and, in MY, subsidy reforms driving cost normalization in fuel, electricity and other input costs.

Figure 43. Headline Inflation and Citi Forecasts



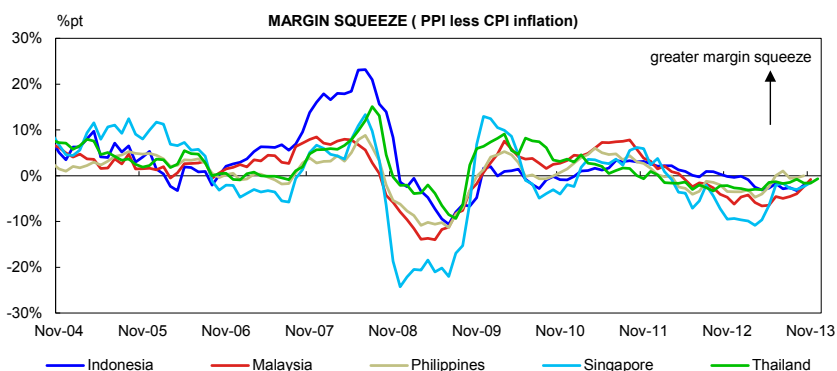
Source: CEIC, Haver, Citi Research estimates

Figure 44. Import Price Inflation



Source: CEIC, Citi Research

Figure 45. Margin Squeeze



Note: We estimate margin squeeze by taking the differential between producer and consumer price inflation (YoY terms). We use the wholesale price indices for Indonesia and Philippines and the domestic supply price index for Singapore in lieu of producer price indices.

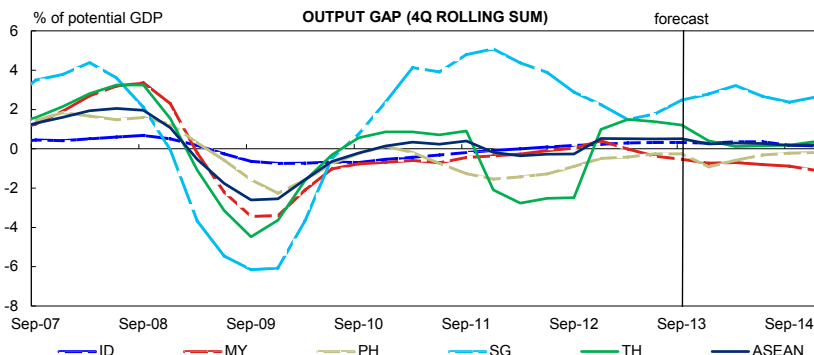
Source: Haver, Citi Research

Except in SG where an export recovery and continuing labour supply constraints could cause the output gap to turn more positive, the trajectory of output gaps are not expected to intensify demand pull pressures anytime soon. In MY, the negative output gap largely reflects capacity additions from the investment boom, which may in turn give BNM a reason to delay rate hikes vs our base case forecast of 25bps each in May and Jul.

Only in MY and PH will inflation be a driver of expected rate hikes from 2Q, with risks of delays. In MY, our expected rate hikes in May and Jul 2014 are predicated on inflation breaching BNM's implicit 3% tolerance threshold, though weak demand-pull pressures suggest risks of delays. While inflation will remain well within BSP's 3-5% inflation target, the transition to a 2-4% target in 2015 could argue for a normalization of rates in 2014, starting from the exceptionally low SDA rates. BI rate hikes will be driven by CA adjustment imperatives, while BOT could cut 25bps in Jan on below-trend growth and subdued core inflation. With core inflation staying within MAS's implicit 2.5% tolerance threshold, we do not expect any FX policy changes in 2014.

Citi's structural reforms index is based on our economists' subjective assessment of reform progress in trade and capital account liberalization, domestic financial liberalisation, tax reforms, labour reform, and land use. MY and PH score relatively better on this count, largely reflecting the expected progress in fiscal reforms and trade liberalization. TH scores poorly, reflecting weak scores in labour reforms and infrastructural development. SG's relatively low score reflects an already strong market orientation, with policies taking a leftward tilt in recent years.

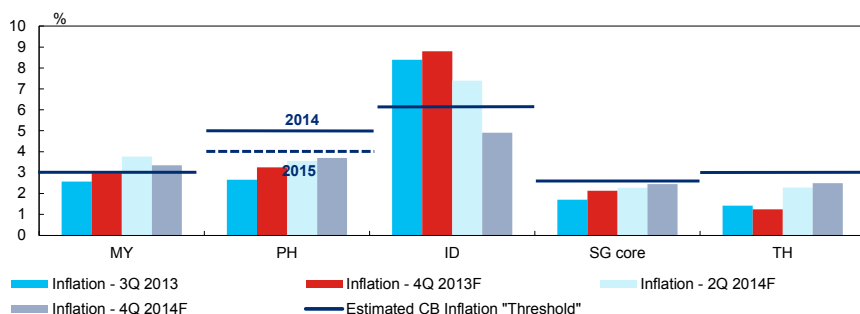
Figure 46. Output Gap



Note: We assume potential growth of 5.5% for Malaysia and 6.5% for Philippines starting 2013 and 3.5% for Singapore starting 2011.

Source: CEIC, Citi Research

Figure 47. Inflation Forecasts vs Central Bank Thresholds



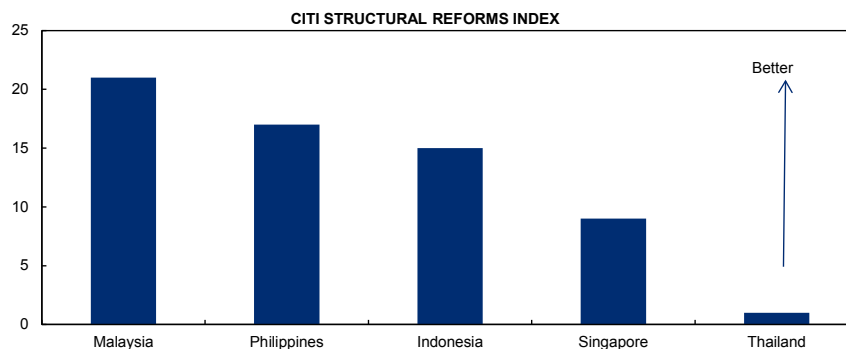
Inflation expected to be lower by June 2013F vs. CB inflation "threshold" ←

→ Inflation expected to be higher by June 2013F vs. CB inflation "threshold"

Note: Inflation forecasts are end of period.

Source: Citi Research

Figure 48. Citi Structural Reforms Index



Source: Citi Research

Electoral cycles will determine the progress of structural reforms (or lack thereof). For ID, structural reforms – including those necessary to correct external imbalances – will likely be put on hold ahead of impending parliamentary and presidential elections on 9 Apr and 9 Jul respectively. Post elections, there could be renewed momentum, with the emphasis on implementation rather than new policy direction. These include infrastructure as the grace period on land acquisition law lapses in 2015. There is also a possibility of another round of fuel price adjustments after the new government takes charge, perhaps in early 2015 (see [Indonesia Macro View - Prospects 2014: How Does Macro Stabilization Mix with Elections?](#)).

In TH, legislative limbo could persist after the 2 Feb elections, as there may not be enough constituencies being contested to fill 95% of the 500 seats in the House of Representatives required to open a new session. The prolonged political gridlock suggests limited room for counter-cyclical policy and implementation of the Bt2rn infrastructure programme could be stalled. Impending elections also suggest the diesel price subsidy is unlikely to be allowed to expire, with attendant hits on the fiscal deficit (see [Thailand Strategy - FY14 Outlook – Bracing for a Subdued Year](#)).

Figure 49. Indonesia election outlook

Election Outlook	With no clear frontrunner in the parliamentary and presidential elections on 9 April and 9 July respectively, Indonesia could be in for another coalition government. Three candidates are expected to run for presidency, but a coalition would mean that power will rest more with the political parties than with the president and that a second round of voting may be needed to elect a president.
Economic Impact	Regardless of which party wins Indonesia's parliamentary election or who emerges victorious in the presidential polls, policies to tackle Indonesia's economic woes will be executed only at end-2014 (a new president will take office on 21 Oct). Distractions from structural reform going into elections will be significant – a number of key posts in the cabinet are currently headed by figures who are either linked to a political party and/or have stated aspirations to contest the 2014 presidential election. Whoever the next president, we think certain issues will be kept off limits – Indonesia runs budget deficits which have been financed mainly by global investors via the government bond market, which should effectively rule out concerns of capital controls on foreign investment income while sanctity of debt servicing will also continue to be kept intact. Unfortunately so far, little is known about the policy direction of the presidential hopefuls, though a more assertive leadership style may expedite the implementation of infrastructure projects – if the next presidency exhibits strong leadership, it may increase the chances of resolving hurdles of projects that are already in the implementation stage. (There will be additional momentum also as the grace period for the 2011 land acquisition law lapses at end-2014). Strong leadership may also possibly increase the momentum on energy subsidy reform.

Source: Citi Research

Figure 50. Political uncertainty into and beyond the Thai elections on 2 February

Key Risks	PDRC has threatened a 'Bangkok Shutdown' by January 13th until caretaker PM Yingluck quits. Red shirt supporters, who are pro-PT, also plan a rally to Bangkok on the same day. The caretaker government may last much longer than normal due to the <u>quorum requirement</u> – if more than 25 MPs cannot be elected, there would be another deadlock after the February election. The <u>Election Committee (EC)</u> has urged the government to re-consider the February 2nd election after violence broke out during the application process. <u>National Anti-Corruption Committee (NACC)</u> is investigating the case to impeach 383 MPs and senators who supported the amendment of the constitution related to senator election. NACC also has taken on investigations related to water management and rice pledging schemes.
Economic Impact	<u>Potentially long period of 'interim' government</u> . Risks point toward a situation whereby either 1) there will be a power vacuum or 2) the election results in fewer than 475 MPs and would require repeated elections in a few areas until a minimum quorum can be achieved. <u>Limited power of interim government means no policy push if there is an economic hiccup</u> . As an interim government is supposed to be for only a short period of a few months, there are regulations to limit its discretionary spending/policy initiatives.

Source: Citi Research

In MY, the government has embarked on a slew of administered price adjustments, frontloading these well in advance of the next elections (due in 2018). While part of the cost normalization process, they also lend evidence of the government's resolve in advancing long awaited fiscal reforms. As one might expect, these price increases have been unpopular – a protest was held on New Year's Eve in KL. While the political risks of public anger over price increases cannot be dismissed, we suspect that the government is unlikely to be moved into backtracking as long as public opposition remains limited and confined to urban – and thus Opposition-leaning – areas like KL.

Figure 51. Recent and planned price increases in Malaysia

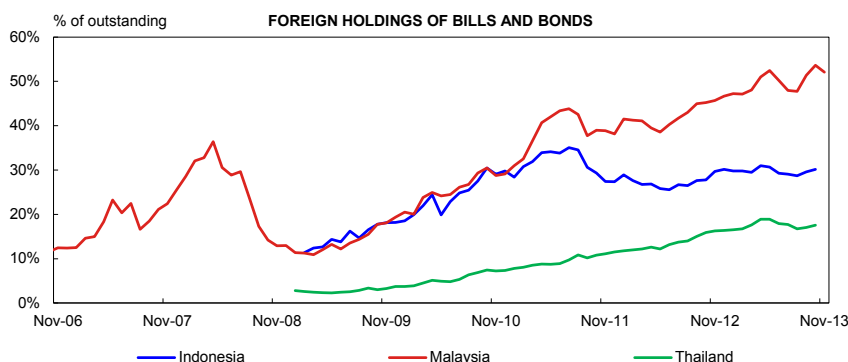
Effective Date	Target	Nominal Price Change	Estimated Impact on CPI Inflation (MoM)	Comments
2-Sep-13	Petrol (RON95) and Diesel	+11%	+0.7%pt	Transport inflation in Sep jumped 4.8%MoM after subsidies for RON95 and diesel were cut by 20 sen.
30-Sep-13	Tobacco	+14%	+0.2%pt	Alcoholic Beverages and Tobacco inflation in Oct surged 11%MoM after the excise tax hike.
26-Oct-13	Sugar	+14%	negligible	Higher YoY headline inflation in Nov was led by Food & Non-Alcoholic Beverages, due to the 34 sen subsidy removal announced at the Budget.
1-Jan-14	Electricity	+15% to 16%	+0.4% to 0.5%pt	We note that past tariff hikes hardly saw any increase for residential users, with industrial users bearing the bulk of the increase.
Mar-14	School bus fares	Up to +40%	Up to 0.3%pt	Land and Public Transport Commission (SPAD) intends to announce a new bus fare scheme in March.
2014	LRT, Monorail, KTM fares			The SPAD has announced its intention to review fares in view of increases in fuel and energy costs.
2014	Highway Toll	+10% to 67%	+0.1% to 0.5%pt	Highway tolls may increase anywhere between RM0.50 and RM2.00. The government has also removed the 20% toll rebate for frequent users in the Klang Valley, which previously amounted to RM30 to RM40 monthly savings for average users.
2H14	KL property assessment rate	Up to +300%	Unclear	The potential impact on the CPI is unclear as the assessment rate is a tax (which may or may not be included in the CPI) and only levied on properties in KL.
Apr-15	GST		+1.0% to 1.4%pt	For details, please see Malaysia Macro View - Prospects 2014: Resistance from Rebalancing

Source: The Star, Citi Research

Despite sell-offs from May-Jul, Oct/Nov data indicate foreign ownership of bills and bonds remains high in ASEAN, especially in ID and MY (MY: 52.1% in Nov vs 53.7% in Oct; ID: 30.1% in Oct vs 29.6% in Sep). During the last major sell-off in 2011, most of the unwinding in MY came from short-term Central Bank and government bills – for bonds, only ID saw a large decline from around Jul/Aug 2011 till mid-2012, while MY never actually saw a decline in foreign ownership of MGS.

In 2011, total unwinding of foreign ownership of bonds and bills in the ASEAN 3 countries amounted to US\$19.8bn between Sep-2011 and Dec-2011, of which around US\$10.9bn came from ID, and the balance largely from MY. Looking at bonds alone, foreign ownership in ASEAN-3 fell by \$7.7bn between Sep and Dec-2011, of which two thirds came from ID. The bulk of the unwinding in ASEAN-3 therefore came from bills, which actually peaked earlier in May 2011 at \$34.4bn, and more than halved to \$15.5bn by Nov 2011 – \$18.9bn of unwinds in total in six months.

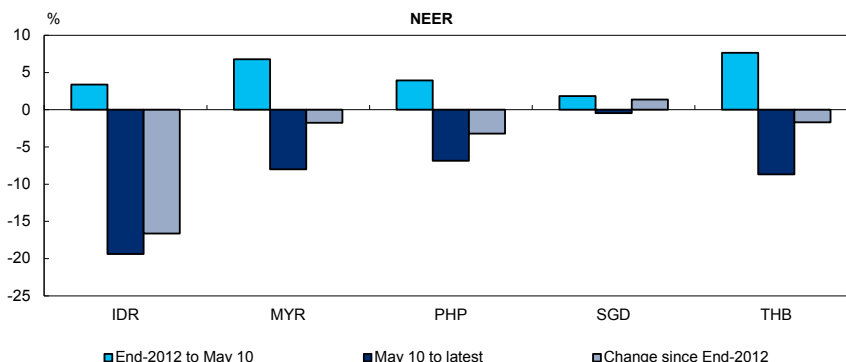
Figure 52. Foreign Holdings of Bills and Bonds



Source: CEIC, Citi Research

ASEAN-5 currencies have depreciated by between 0.5% and 19% on a NEER basis since 10 May 2013, with the sharpest declines unsurprisingly in IDR. Only SGD has not given up its gains from the start of 2013, reflecting its safe-harbor and regional private banking/asset management hub status, and the strong SGD policy. Despite its recent weakness, THB has given up less of its gains at the start of the year vs MYR and PHP, which may suggest room for further weakness. The sell-off in PHP has been severe relative to fundamentals.

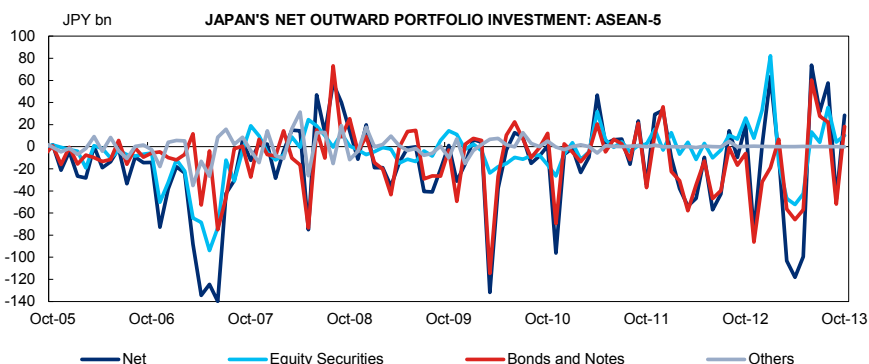
Figure 53. NEER Performance



Source: Haver, Citi Research

Bond portfolio flows from Japan have been volatile, returning to ASEAN in Sep post the Taper delay at the Sep FOMC meeting, but this proved short-lived as bond investors pulled out of ASEAN-5 once again in Nov. Japanese investors however remained net sellers of ASEAN equities.

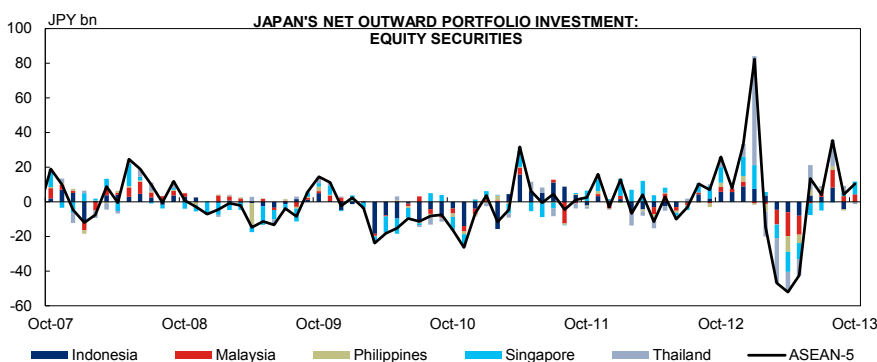
Figure 54. Japan's Net Outward Portfolio Investment: ASEAN-5



Source: CEIC, Citi Research

On the equity front, while TH and ID saw the greatest initial selling pressure by Japanese portfolio investors in May-Jul, net selling in MY and SG has picked up more steam from Aug.

Figure 55. Japan's Net Outward Portfolio Investment: Equity Securities

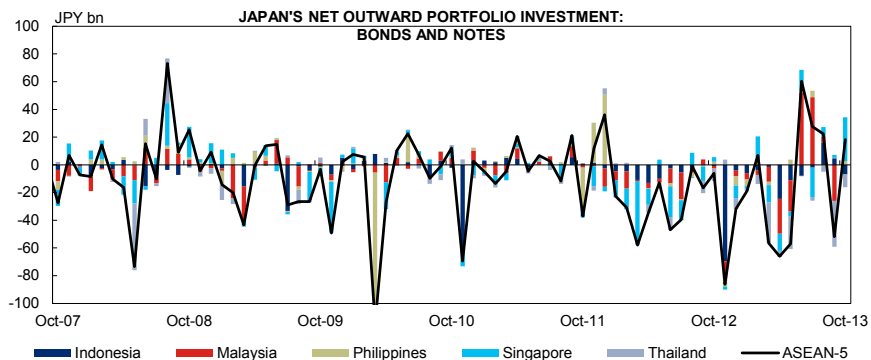


Source: CEIC, Citi Research

On the bond side, the greatest swing in Japanese flows was seen in MY, which saw net inflows in Sep (possibly on evidence of the improving CA position). Up till Oct, Japanese investors were still net buyers of TH bonds, perhaps in expectation of a rate cut. Reflecting low yields, Japanese investors remained net sellers of SG. Oct data indicated some buying interest in ID.

Ranking ASEAN currencies according to various vulnerability criteria, apart from slow CAD adjustment, political risk premia and further rate cuts will weigh on the THB at least near term. While IDR remains vulnerable in a taper environment, we would not rule out positive surprises in the CAD or elections. SGD is in the middle, with its safe-harbor properties and positive slope of the band offset by negative carry. Improving CA, fiscal dynamics and rate hikes could help MYR though heavy foreign positioning remains a headwind. We like PHP on strong CA dynamics, good growth prospects, and possible rate hikes.

Figure 56. Japan's Net Outward Portfolio Investment: Bonds and Notes



Source: CEIC, Citi Research

Figure 57. FX Vulnerability Ranking

Vulnerability Ranking (higher = more vulnerable)	IDR	MYR	PHP	SGD	THB
Relative gains/losses	1	2	3	5	4
Foreign positioning	4	5	1	3	2
Policy rate action	4	2	1	3	5
Confidence on structural reforms	4	1	2	3	5
Growth prospects, incl. exposure to G3 vs Asia, vulnerability to tapering	4	2	1	3	5
FX reserve adequacy	5	4	2	1	3
Total	22	16	10	18	24

Note: We rank the ASEAN currencies by our estimates of vulnerability – the higher the ranking, the more vulnerable the currency on that dimension.

Source: Citi Research Estimates

Appendix A-1

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