

ASEAN Macro View

Chartbook: Current Accounts – A Savings-Investment Perspective

■ CA deterioration generally not yet at 1997 levels, but no cause for complacency

— While CA balances have been deteriorating amongst most in ASEAN, only ID's is close to 1997 levels. Even so, we note that the 1997 AFC was preceded by many years of sustained CA and basic balance (CA + net FDI) deficits in the ASEAN-4 (ex SG), which is far from the case now, while FX reserve adequacy remains better than pre-1997 levels. This is no cause for complacency however, and we dig deeper into savings-investment data to assess the sustainability of CA trends in the "problem" economies of ID, MY and TH.

■ A fall in savings or rise in investments? — CA deterioration is arguably less worrying if driven more by rising investments rather than falling savings (or excessive consumption). While rising investment to GDP ratios are a common driver, ID and MY saw sizeable falls in savings rates, reflecting declines in public savings (partly due to fuel subsidies) and perhaps private savings (lower commodity prices hitting rural incomes and debt-driven consumption in MY). TH savings rates could fall if populist public consumption programmes are not reined in or private consumption is driven by rising household debt rather than incomes.

■ Productive investments in tradable or non-tradable sectors? — Investments in tradables sectors that generate export earnings in the future can mitigate CA deterioration. Tradables sectors seem to play a more important role in MY and TH, but ID investments have been concentrated in non-tradable building/construction, even as tradables stagnated. While measuring investment efficacy is far from simple, proxies including incremental capital-output ratios (ICOR), return on invested capital (ROIC) and inventory build-up suggest somewhat less favourable trends for ID on balance.

■ Overall, ID's CAD drivers most worrying followed by MY; TH benign for now —

With ID's net external debtor status (more FCY liabilities than FCY assets) limiting the extent to which it can tolerate IDR weakness, the brunt of adjustment may have to be via slower growth on fiscal/monetary tightening – [we think BI needs to hike 50bps and signal a more hawkish stance](#). While [recent measures could encourage investments in tradables and infrastructure to improve investment efficiency](#), these may only shave off 0.3-0.4% of GDP from the CAD on an annualized basis, likely with a lag. Net external creditors MY and TH can still afford to let a weaker currency bear a greater brunt of the adjustment – BNM and BOT thus have less urgency to hike, which would also avoid aggravating any tightening in financial conditions from a weaker FX. While MY continues to run a CA surplus vs TH's deficit, MY's higher speed of deterioration argues for greater urgency in arresting the decline in public and private savings, primarily via measured fiscal tightening and macroprudential tightening to curb debt-driven consumption and non-tradables investments. Although CA dynamics in TH are more benign for now, caution needs to be exercised against populist "wasteful" programmes that run down public savings as well as excessive debt-fuelled private consumption.

Head of ASEAN Economics; Malaysia and Singapore

Wei Zheng Kit
+65-6657-5079
wei.zheng.kit@citi.com

Indonesia

Helmi Arman
+62-21-5290-8960
helmi.arman@citi.com

Philippines and Thailand

Jun Trinidad
+63-2-894-7270
jun.trinidad@citi.com

Brian Tan
brian.tan@citi.com

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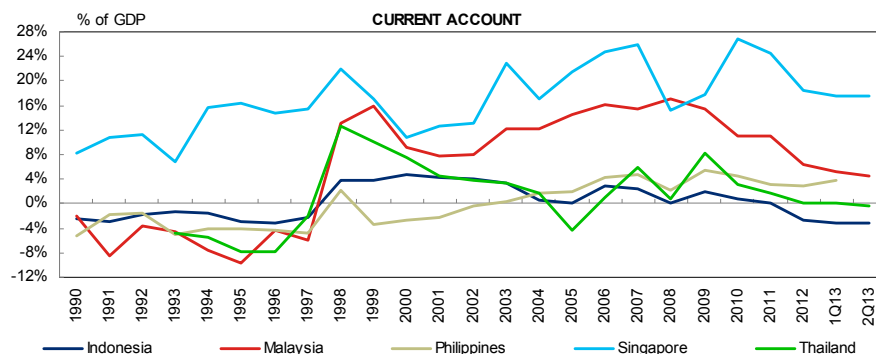
ASEAN Current Accounts – A Savings-Investment Perspective

While current account balances have been deteriorating amongst the ASEAN-5, only ID's is close to 1997 levels. For example, MY and TH saw CA deficits averaging around 6.4% and 5.6% of GDP in respectively from 1993-1997 vs surpluses of 7.3% and 0.5% from 2011-1H13. Even so, the 1997 Asian Financial Crisis was preceded by years of persistent CA deficits in the ASEAN-4 (ex SG) – which is far from the case at present. In other words, while recent trends are valid source of concern, imbalances could still be corrected if policy remedies are undertaken early.

ID's basic balance deficit is at 1997 levels, but TH's CA deficit has been financed by long term FDI inflows. MY recorded its first quarterly basic balance deficit since 3Q97 in 2Q13, but unlike ID which runs a CA deficit, MY is still in a CA surplus. While the excess savings from CA surpluses in MY have been recycled abroad in the form of ODI, the basic balance deficit now implies that ODI now exceeds the flow of excess domestic savings (and is thus being funded by the stock of past savings). In both MY and TH, weaker currencies and other policy steps could potentially dampen ODI and bolster the basic balance.

Liquidity buffers also remain strong relative to pre-1997 levels. Central banks have also built up FX reserves – ex ID, ASEAN-4 reserves remain several times above external financing requirements (ST external debt + amortizations). Even in ID, FX reserve coverage ratios remain above 1997 levels, and this would remain the case even after taking into account the wider CA deficit.

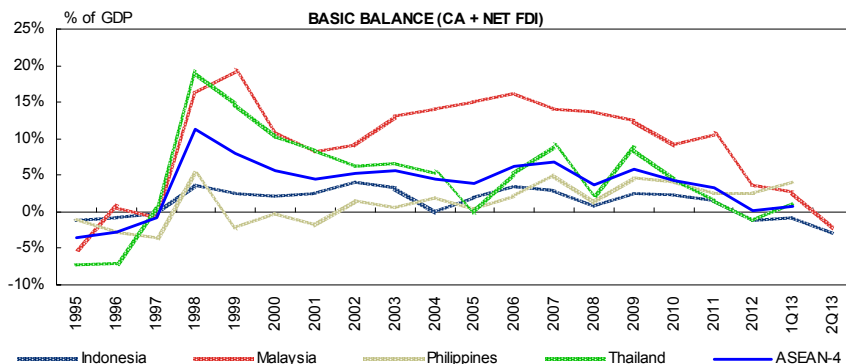
Figure 1. Current Account



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

Source: CEIC, Haver, Citi Research

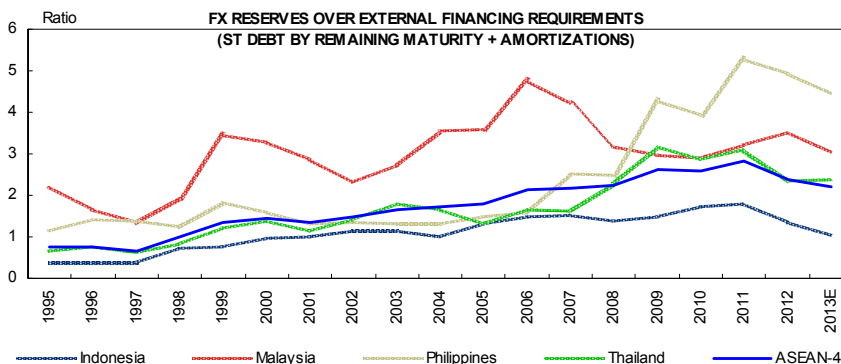
Figure 2. Basic Balance



Note: Data is annual except for 1Q13 and 2Q13 where we calculate single quarter basic balances.

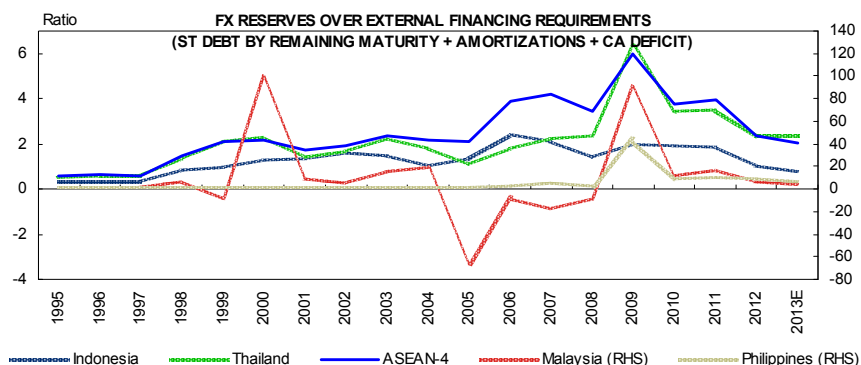
Source: CEIC, Haver, Citi Research

Figure 3. FX Reserves over Financing Requirements (ST Debt + Amortization)



Source: CEIC, Haver, Citi Research Estimates

Figure 4. FX Reserves over Financing Requirements (ST Debt + Amortization + CA Deficit)



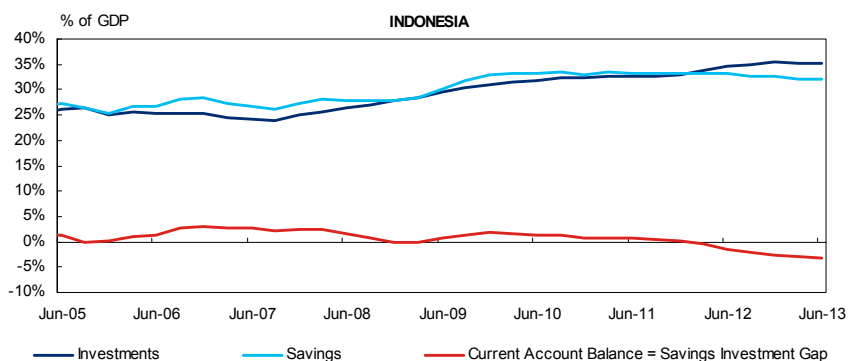
Source: CEIC, Haver, Citi Research Estimates

Deterioration in Savings or a Rise in Investments?

We dig deeper into savings-investment data to assess sustainability of CA trends in ID, MY and TH where deterioration in CA positions have been more severe. This framework assesses CA sustainability by looking at (1) whether CA deterioration is because of rising investments or declining savings, (2) whether investments are in tradables or non-tradables sectors, and (3) whether investments are efficient or not. Since the CA balance is equivalent to the savings-investment gap¹, deterioration can emerge from either lower savings and/or higher investments. A CA deterioration is less worrying if it finances new investments that generates future earnings rather than consumption, which reduces savings.

In addition to a rise in investments, a sizeable fall in the national savings rate since 2011 has also played an important role in ID. While the breakdown between public and private savings is not published for ID, the fall in ID private savings from late 2012 likely was driven by the fall in commodity prices.

Figure 5. Savings-Investment Gap: Indonesia



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

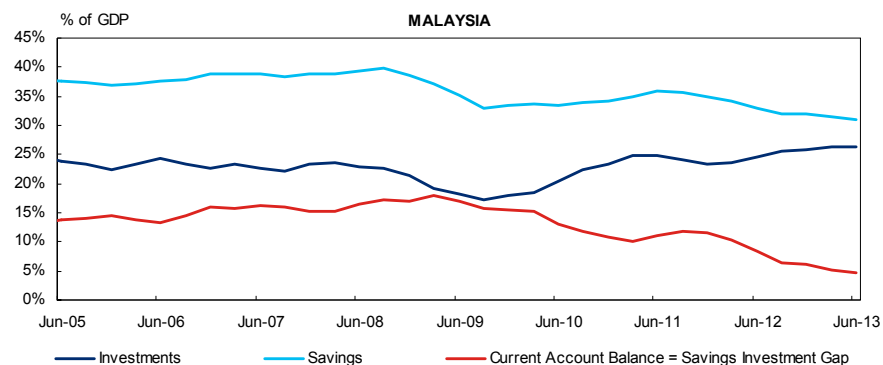
Source: Source: CEIC, Citi Research Estimates

¹ This relationship can be derived from the national income identity: $Y = C + I + G + X - M$ (1)

Where Y is measure of value of goods & services produced in the country (for data convenience, we use GDP instead of GNP), C is private consumption, I is investment, G is government expenditures, X is exports of domestically produced goods & services and M is imports of domestically produced goods and services. The current account (CA) can be written as $CA = X - M$ and Savings $S = Y - C - G$, and re-writing (1), we get the following relationship: $CA = Y - C - G - I = S - I$ (2)

Similarly for MY, the narrowing CA surplus since 2009 was both a function of rising investments (since 2010) as well as falling savings. Compared to ID, the contribution of a falling savings rate to CA deterioration has been arguably larger, reflecting both falling public and private sector savings.

Figure 6. Savings-Investment Gap: Malaysia



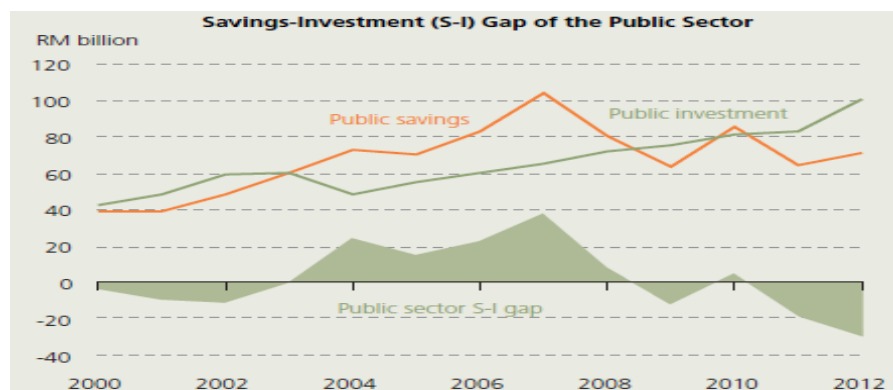
Note: We calculate the savings rate implied by investments and current account balances. Data is quarterly on a 4-quarter rolling sum basis.

Source: Source: CEIC, Citi Research Estimates

Both the private and public sector S-I gaps in MY registered declines in recent years. In the public sector, this reflected larger fiscal deficits in the wake of the economic stimulus packages introduced in 2009, while the Economic Transformation Programme (ETP) since 2010 has also driven investments by public enterprises.

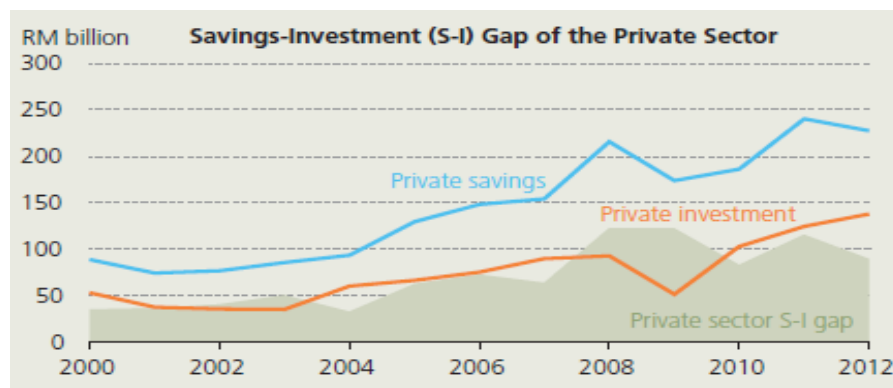
Although the decline in Malaysia's private S-I gap was largely due to higher investments, private savings also tapered off in recent years as a result of falling commodity prices hurting rural household incomes – aggravated in MY's case by a debt- (as opposed to income-) driven private consumption binge, which has accelerated in the post-GFC period.

Figure 7. Savings-Investment Gap of Public Sector: Malaysia



Source: Bank Negara Malaysia Annual Report 2012

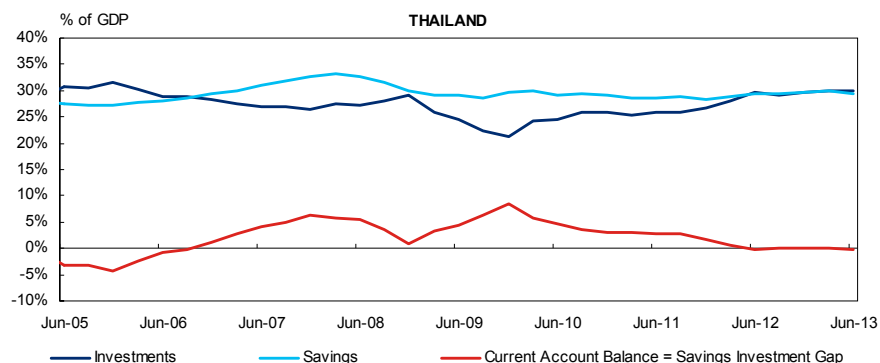
Figure 8. Savings-Investment Gap of Private Sector: Malaysia



Source: Bank Negara Malaysia Annual Report 2012

TH savings rates have held relatively steady, though this could come under pressure in the future as the government ramps up its public infrastructure programme and/or if household leverage and other populist fiscal schemes driving consumption becomes a bigger issue.

Figure 9. Savings-Investment Gap: Thailand



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

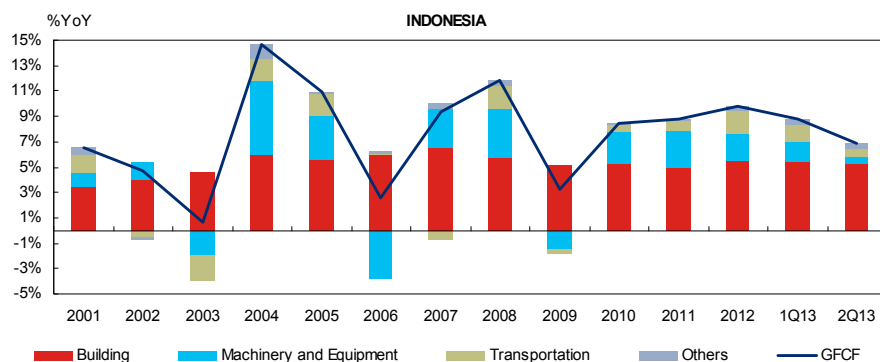
Source: Source: CEIC, Citi Research Estimates

Investments in Tradables or Non-Tradables Sectors?

A CA deficit would probably be less worrying if driven by investments in tradables sectors that would ultimately generate export earnings in the future to repay foreign borrowings. 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.

In ID, construction investments in non-tradables building sectors has accounted for 70% of overall GFCF in recent years. Machinery and transport equipment investments (for import substitution) as well as exports could potentially reduce external imbalances in the future, but these have slowed in recent years.

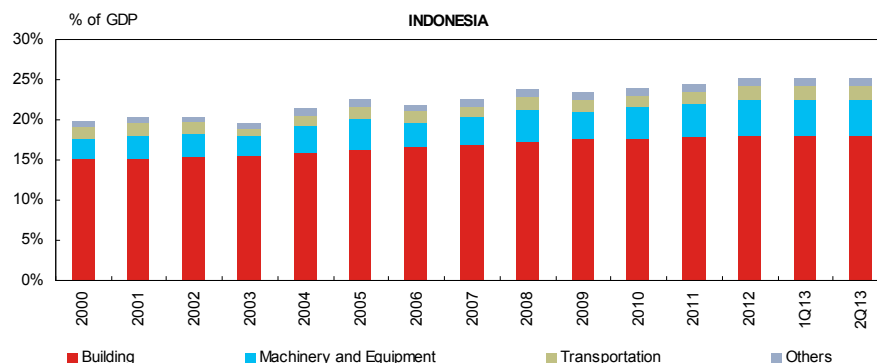
Figure 10. Gross Fixed Capital Formation: Indonesia (%YoY)



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

Source: CEIC, Citi Research

Figure 11. Gross Fixed Capital Formation: Indonesia (% of GDP)



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

Source: CEIC, Citi Research

That said, 70% of "building" investments comprises 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, though this does not fundamentally resolve the FX demand-supply imbalance caused by the importation of capital goods for these investments.

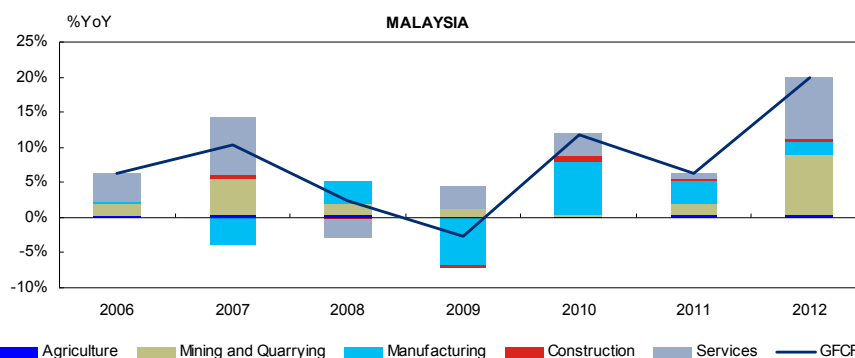
In MY, investments in tradables (agricultural, mining, and construction) accounted for 40% of the absolute level of investments and 63% of GFCF growth in recent years. 2012 saw a surge in investments in mining and quarrying, largely oil and gas. While a more granular breakdown of services investments is not available, a part could be reasonably considered tradable, e.g. aircraft imports for airlines. That said, anecdotally, investments in non-tradables sectors within residential and commercial real estate (captured both in construction and services) have also picked up and deserve further investigation.

Figure 12. Completed Construction: Indonesia

Type of Construction		2004	2005	2006	2007	2008	2009	2010	2011
Building Construction	IDR bn	23,378	28,197	31,375	34,612	33,078	71,472	93,706	107,418
Civil Construction	IDR bn	21,500	24,379	26,049	28,616	46,242	137,099	164,791	199,261
Especially Construction	IDR bn	11,127	14,742	14,519	18,447	22,695	47,057	54,676	63,700
TOTAL	IDR bn	56,005	67,318	71,943	81,675	102,016	255,628	313,173	370,378
Building Construction	% of total	41.7%	41.9%	43.6%	42.4%	32.4%	28.0%	29.9%	29.0%
Civil Construction	% of total	38.4%	36.2%	36.2%	35.0%	45.3%	53.6%	52.6%	53.8%
Especially Construction	% of total	19.9%	21.9%	20.2%	22.6%	22.2%	18.4%	17.5%	17.2%

Source: BPS (Indonesia), Citi Research

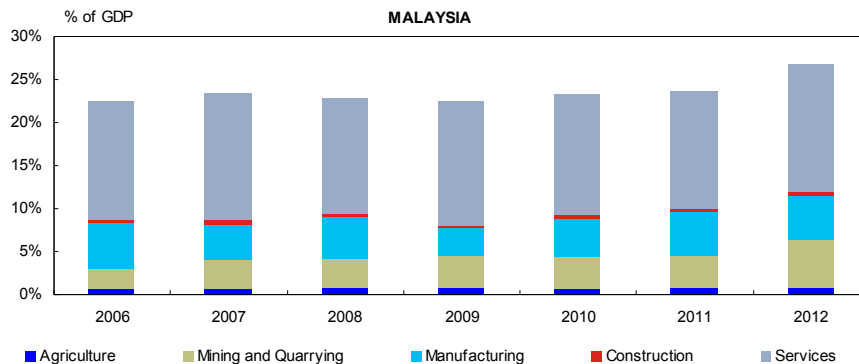
Figure 13. Gross Fixed Capital Formation: Malaysia (%YoY)



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

Source: Department of Statistics (Malaysia), Citi Research

Figure 14. Gross Fixed Capital Formation: Malaysia (% of GDP)

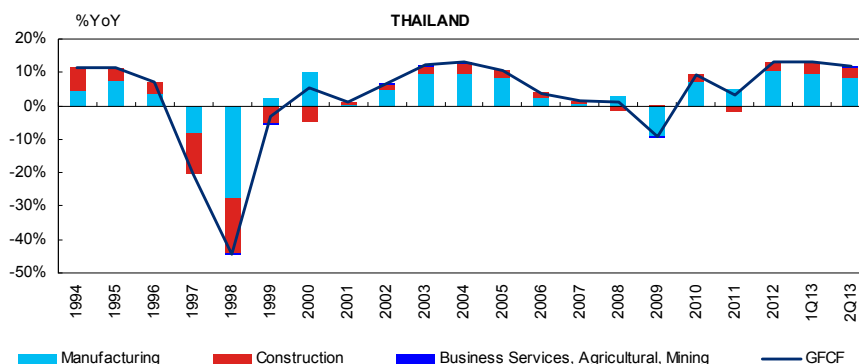


Note: Data is annual except for 1Q13 and 2Q13 where we use 4-quarter rolling sums.

Source: Department of Statistics (Malaysia), Citi Research

For TH, unlike the pre-1997 period which saw investments dominated by construction activity, investments in manufacturing sector accounted for around 70% of overall investments since 2011 (though some of this may be to meet domestic demand). If the public infrastructure programme takes off, the non-tradables contribution is likely to increase (largely in construction), though this could generate indirect spillovers to tradables sectors via the boost to regional inter-connectivity.

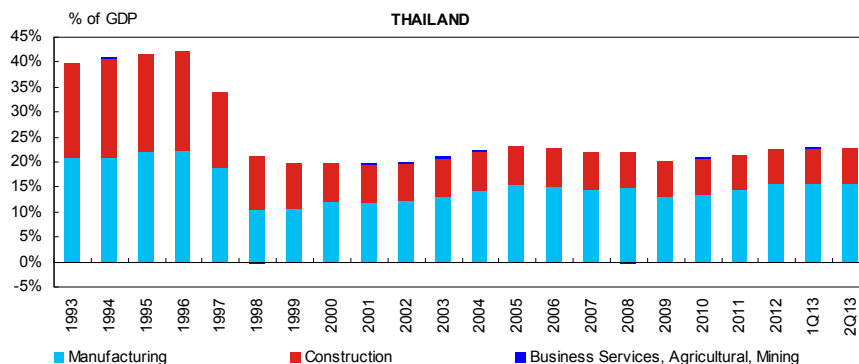
Figure 15. Gross Fixed Capital Formation: Thailand (%YoY)



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

Source: CEIC, Citi Research

Figure 16. Gross Fixed Capital Formation: Thailand (% of GDP)



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

Source: CEIC, Citi Research

How efficient or productive are investments?

There are many measures to ascertain the productivity of investments, the broadest of which is the incremental capital to output ratio (ICOR)², though for comprehensiveness, we also examine alternative measures such as return on invested capital (ROIC) and contribution of inventories to overall investments.

Based on these three measures of investment efficiency, there may need to be greater concern in ID (because of inventory build up and falling ROIC), followed perhaps by MY and TH.

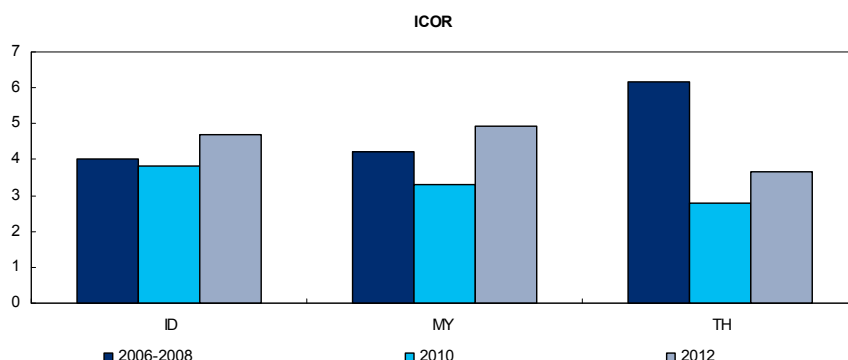
ICOR gives an indication of broad investment efficiency at the macro level, though data limitations mean that this can be a tricky concept to measure or interpret.

Our proxy for ICOR would suggest an increase across all three countries since 2010, but perhaps more so in MY and ID rather than TH. We note some caveats in interpreting the data however. For MY, the rise in ICOR may simply reflect the significant time taken to translate sizeable investments in MRT projects and oil and gas to actual output. In ID, ICOR may be distorted upwards by the shrinking output of the oil industry which has actually seen limited investments.

ID has seen the highest ROIC, though this has been declining since the 2011 (especially ex Financials) – corroborating the rising ICOR result. However, ROIC in MY has been rising, while TH has been steady.

An important caveat with regard to our ROIC measure is that it only includes large listed companies for which investments may not necessarily be in the home country, e.g. MY listed corporates investing in ID for example.

Figure 17. Proxy for ICOR

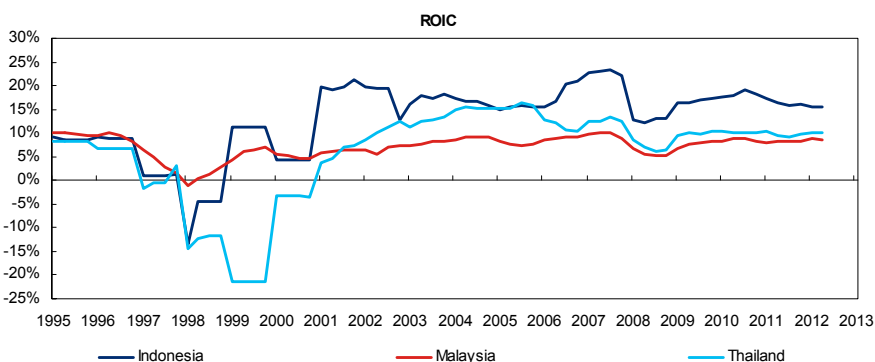


Note: Given the lack of net capital stock data in ID, we use the real gross (as opposed to net) capital formation as a proxy for the change in capital stock (i.e. ignoring the impact of capital depreciation) for consistency across countries.

Source: CEIC, Citi Research Estimates

An alternative measure of investment efficiency is the Return on Invested Capital (ROIC) measure for listed companies, which gives a sense of how well a company is using its money to generate returns.

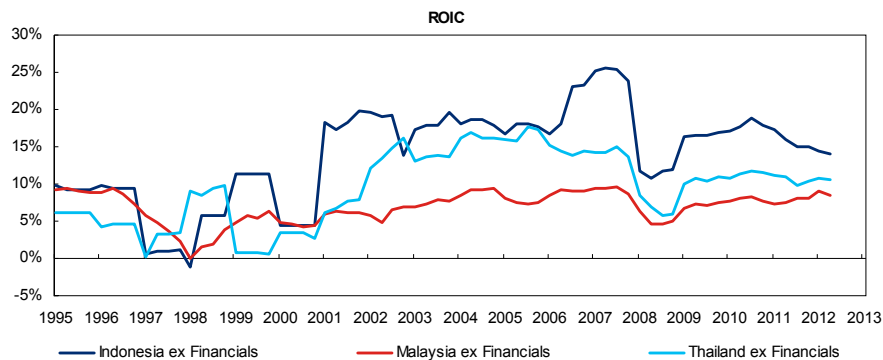
Figure 18. Return On Invested Capital



Source: Citi Research Estimates

² ICOR assesses the marginal amount of investment capital necessary for an entity to generate the next unit of production. Overall, a higher ICOR value is not preferred because it indicates that the entity's production is inefficient. The measure is used predominantly in determining a country's level of production efficiency. ICOR is calculated as: $ICOR = \text{Annual Investment} / \text{Annual Increase in GDP}$

Figure 19. ROIC ex Financials

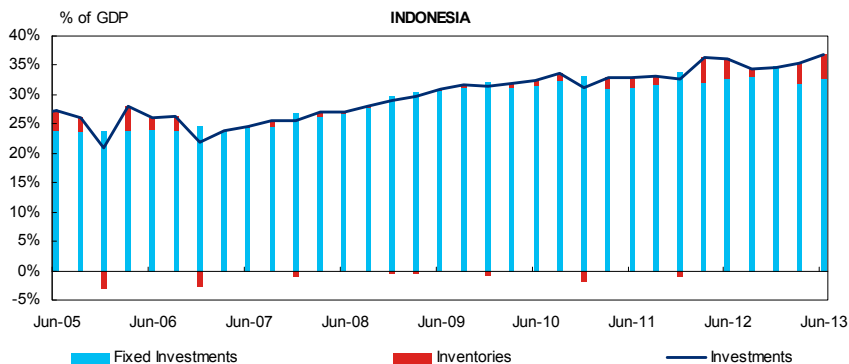


Source: Citi Research Estimates

We note also that the investment data used in the CA calculations is domestic gross capital formation, which also includes change in stocks, and this must be accounted for when deciding if investment is merely contributing to over-capacity in sectors with insufficient demand.

For ID, the recent increase in the investment to GDP ratio has been dominated by inventory build up of unsold goods (especially commodities we suspect), even as GFCF stagnated as a % of GDP.

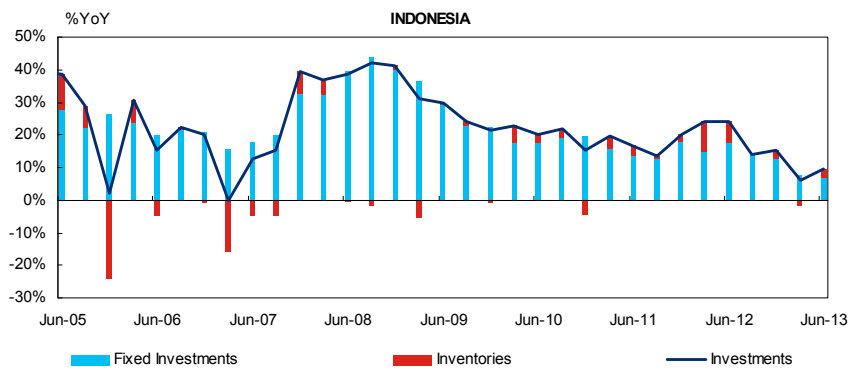
Figure 20. Fixed Investments and Inventory Change: Indonesia



Note: Data is single quarter.

Source: CEIC, Citi Research

Figure 21. Fixed Investments and Inventory Contribution to Investment Growth: Indonesia

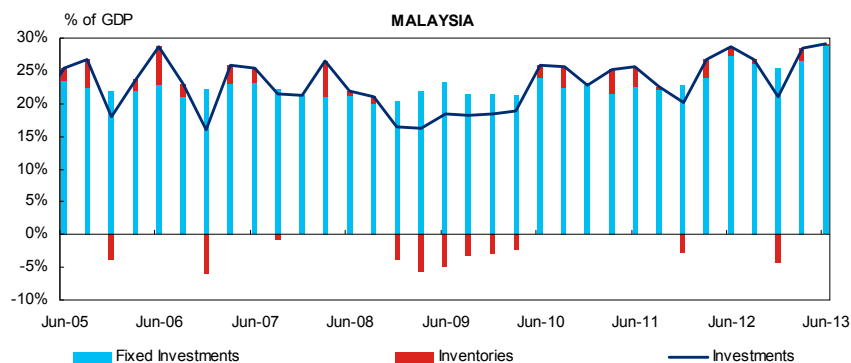


Note: Data is single quarter.

Source: CEIC, Citi Research

For MY and TH however, inventory build up has been minimal – in fact, when looking at growth rates, MY has been consistently de-stocking since 2011

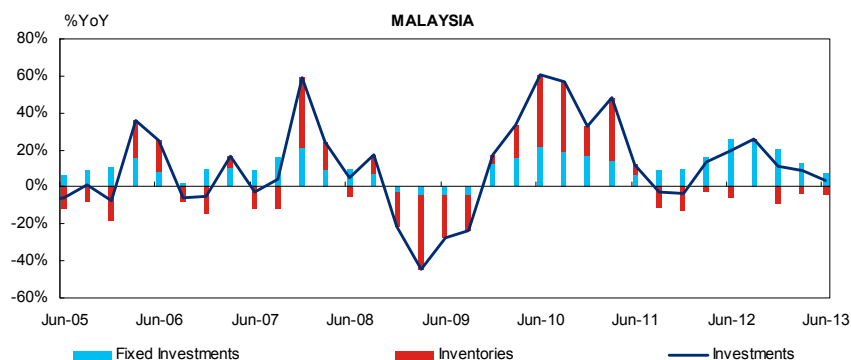
Figure 22. Fixed Investments and Inventory Change: Malaysia



Note: Data is single quarter.

Source: CEIC, Citi Research

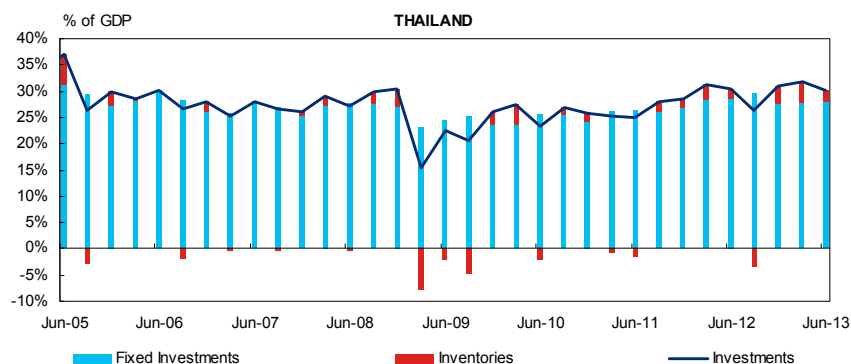
Figure 23. Fixed Investments and Inventory Contribution to Investment Growth: Malaysia



Note: Data is single quarter.

Source: CEIC, Citi Research

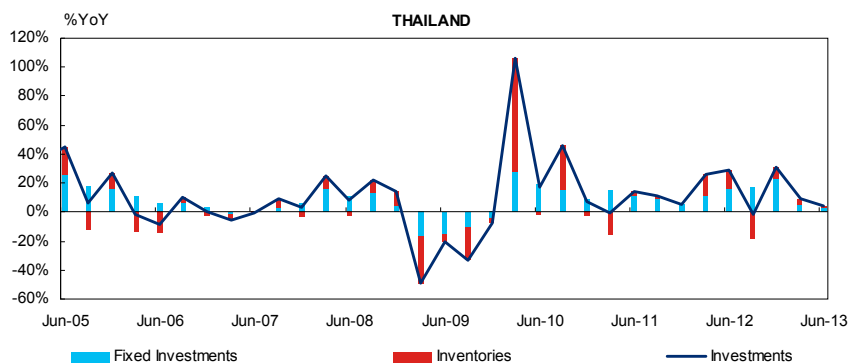
Figure 24. Fixed Investments and Inventory Change: Thailand



Note: Data is single quarter.

Source: CEIC, Citi Research

Figure 25. Fixed Investments and Inventory Contribution to Investment Growth: Thailand



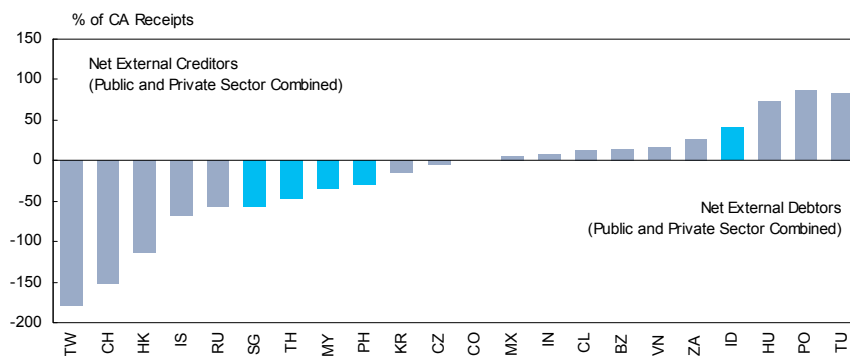
Note: Data is single quarter.

Source: CEIC, Citi Research

Conclusion

Taking these factors into consideration, even without considering how the CA deficit is financed, ID's CAD is most worrisome, with MY in the middle and TH's situation the most benign (for now). With its net external debtor status limiting the extent to which it can adjust via a weaker IDR, the brunt of external adjustment may have to be via significantly slower growth on fiscal/monetary tightening. This could take place by either raising savings, reducing investments, or re-allocating investments to the tradables sectors. Since fiscal tightening (undertaken via the fuel subsidy reduction) has already taken place, the baton has passed on the BI to hike rates or undertake macroprudential tightening to moderate consumption/non-tradables investments. Alternatively, the government could implement more policies like the [recently announced measures](#) to help encourage investments in tradables sectors as well as raise investment efficiency via infrastructure. Even so, our Indonesia economist Helmi Arman notes that these measures may only shave off 0.3-0.4% of GDP from the CAD on an annualized basis, likely with a lag.

Figure 26. Net External Debt



Source: Fitch Data Comparator (March 2013)

Because MY and TH are both net external creditors, they can afford to let weaker currencies (as opposed to slower growth) bear a greater brunt of the adjustment than ID, though the net impact of weaker FX on overall financial conditions may not be positive if also accompanied by weaker stock markets and higher bond yields. To avoid aggravating any deterioration in financial condition, this also implies BNM and BOT have less urgency than BI to hike.

Even though MY continues to run a CA surplus vs TH's deficit, MY's larger speed of deterioration – driven to a larger extent by a running down of public and private savings – and higher concentration in the non-tradables sectors would argue for relatively greater urgency in tackling the issue via somewhat slower growth, primarily via measured fiscal tightening to either raise revenues (for example by implementing GST) or curb public consumption (reducing fuel subsidies). Macroprudential tightening to curb household debt and excessive private consumption may also be necessary to arrest declines in private savings.

As for TH, while CA dynamics look relatively more benign at present, policymakers need to exercise caution against populist "wasteful" programmes that run down public savings as well as excessive debt-fuelled private consumption. The public infrastructure spending may further pressure CA deficits in the coming years, but the boost to regional trade from improving regional connectivity – if realized – would help boost future export earnings.

Appendix A-1

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