

ASEAN Rising: Key Growth Drivers Shaping the Region

Key Points

- More than two decades on, ASEAN economies have strengthened their defences against potential external shocks in the aftermath of the Asian Financial Crisis.
- With strong fundamentals underpinned by favourable demographics, ASEAN's growth prospects have made the region an attractive investment destination.
- Key growth drivers include strong FDI inflows, resilient domestic consumption led by growing middle class wealth and urbanisation, continued financial product penetration across the region, and accelerating infrastructure development.
- We see resilient ASEAN economic growth, a pause in the Fed rate hike cycle and limited USD strength providing support to equities in the region.
- Investment themes we intend to exploit here in ASEAN include changing domestic consumption profiles, pre-election government spending, infrastructure development, financial product penetration and increasing connectivity.

More than two decades after the Asian Financial Crisis (AFC), Asia has made rapid progress on the growth and development fronts. In particular, ASEAN countries that were among the hardest hit during the crisis – Thailand, Indonesia, Malaysia and the Philippines – have shored up their defences against potential external shocks in its aftermath. Governments in these countries have put in place sound macroeconomic policies supported by greater fiscal prudence, implemented structural reforms, and strengthened financial sector regulation and governance. As a whole, ASEAN economies have rebuilt their foreign reserves while inflation and interest rates have been generally well managed. Recent pre-emptive behaviour adopted by the region's central banks, amid a rate normalisation cycle in the US, bears testimony to a coming of age by policy makers and warrants further comfort.

An Attractive Investment Destination

On the back of such stronger economic fundamentals, ASEAN's favourable growth prospects have made the region an attractive investment destination. Foreign direct investment (FDI) flows to ASEAN rose from US\$123 billion in 2016 to an all-time high of US\$137 billion in 2017². Intra-ASEAN investments, the biggest contributor to FDI flows in the region, reached a new high of US\$27 billion in 2017, contributing 19% to total inflows². The largest source of intra-regional investments was Singapore (69%), followed by Malaysia and Thailand, but it is worth noting that foreign multi-national corporations also invested through their Singapore operations in other ASEAN countries².

Overall, ASEAN is expected to gain from foreign direct investments, which will in turn reinforce the region's role as an up-and-coming manufacturing hub for the world. Collectively, ASEAN economies represent the world's fifth largest manufacturing economy, underscoring the region's rising importance as a global manufacturing powerhouse, both in advanced manufacturing³ and low cost manufacturing. In terms of low-cost manufacturing, Vietnam in particular, has made great strides as a manufacturing hub attracting significant investment from foreign businesses⁴. Continued FDI into and expansion of ASEAN's manufacturing sector are key to reducing poverty and raising productivity, paving the way for more inclusive growth in the region.

Domestic Consumption to Drive Growth

External growth drivers aside, domestic consumption remains a key driver to ASEAN's intrinsic growth, and an important enabling factor for the region to remain and fulfil its potential as a growth engine for the world. Consumption needs and patterns are expected to shift as a result of changes in population mix (e.g. better adult literacy, larger working class) increasing external investments and rising household disposable income⁵. Meanwhile, a pick-up in rural spending is expected this year in the run-up to election cycles in countries like Indonesia, Thailand and the Philippines. All things considered, rising urbanisation, an expanding labour force, rising incomes and an upgrade in worker skillsets will be key drivers of change in the region.

Digital Economy Presents Opportunities

Elsewhere, financial product penetration continues to gain traction across the region, while technology-led disruption is here to stay. We are witnessing how the digital revolution is disrupting and transforming industries, businesses and the delivery of goods and services in ASEAN. The emergence of the digital economy has brought both challenges and

opportunities for businesses, in areas such as e-commerce and payment systems. We expect such developments to alter the business models of companies here in the region as more than 300 million internet users fuel a US\$50 billion ASEAN internet economy, which is projected to become a US\$200 billion economy by 2025⁶.

Infrastructure Spending Set to Accelerate

On the fiscal front, we also see government support facilitating public consumption, household spending and gross fixed investment. Here, we see infrastructure development being a multi-year theme across ASEAN. Notable projects include the Belt and Road initiative, the Philippines' US\$180 billion "Build, Build, Build" initiative and Indonesia's continued infrastructure drive under President Jokowi. The launch of the Asian Infrastructure Investment Bank (AIIB) back in 2016 also contributes to infrastructure development in the region; examples of recently approved projects by the AIIB include the Strategy Irrigation Modernization and Urgent Rehabilitation Project in Indonesia and the Metro Manila Flood Management Project in the Philippines. City-state Singapore is also playing her role in chairing the Asia-Singapore Infrastructure Roundtable, a platform for dialogue between government leaders, policy makers, investors and infrastructure companies on Asian infrastructure projects.

Our Strategy

In the near term, we are cognisant of potential challenges in ASEAN, which may be brought about by extraneous macro sources of risk; these in turn may result in rising earnings risks and tightening liquidity. Ongoing US-China trade tensions, political uncertainty (upcoming elections in Asia and the Brexit stalemate) and US interest rate directions are likely to result in another volatile year for equities.

Specifically in Asia, the export cycle is stalling as the lagged impact of trade tensions and slower

growth in the developed markets take their toll. Nevertheless, China's policy stance is likely to be supportive and may provide some buffer to regional growth. All things considered, we see resilient ASEAN economic growth, a pause in the Fed rate hike cycle and limited USD strength providing support to equities.

With greater volatility in financial markets, we believe sharp swings in sentiment can present

opportunities to invest in ASEAN names that may have been mispriced. We continue to be disciplined, maintaining our focus on bottom-up security selection, which we expect to play a greater role in generating returns this year. Investment themes we intend to exploit here in ASEAN include changing domestic consumption profiles, pre-election government spending, infrastructure development, financial product penetration and increasing connectivity.

References:

¹ Source: IMF, *World Economic Outlook Update, January 2019*

ASEAN-5 countries are Indonesia, Malaysia, the Philippines, Singapore and Thailand

² ASEAN Investment Report 2018 – *Foreign Direct Investment and the Digital Economy in ASEAN*

³ Source: EDB website, 21 May 2018. In the article, "Singapore: A Leading Manufacturing Hub", Singapore is cited as the fourth largest global exporter of high tech exports. Manufacturing remains a significant contributor to Singapore's economy, contributing about 20 per cent to its GDP.

⁴ ASEAN Briefing – "Growing Opportunities for Manufacturing in ASEAN", 12 April 2018.

⁵ The article "Household spending could double across six ASEAN countries by 2030: DBS", published by the Business Times on 25 July 2018, cited that the combined consumer spend of Indonesia, Thailand, the Philippines, Vietnam, Malaysia and Singapore could nearly double between 2017 and 2030, according to DBS analysts.

⁶ Source: ASEAN Investment Report 2018 – *Foreign Direct Investment and the Digital Economy in ASEAN*.

Disclaimer: No offer or invitation is considered to be made if such offer is not authorised or permitted. This is not the basis for any contract to deal in any security or instrument, or for Fullerton Fund Management Company Ltd (UEN: 200312672W) ("Fullerton") or its affiliates to enter into or arrange any type of transaction. Any investments made are not obligations of, deposits in, or guaranteed by Fullerton. The contents herein may be amended without notice. Fullerton, its affiliates and their directors and employees, do not accept any liability from the use of this publication.