ASEAN EQUITIES – CAN THE GROWTH RENAISSANCE CONTINUE IN 2017?

"Find growth and you will find performance" was our Asian Equity investment mantra in early 2016 as the world grappled with slowing growth and lethargy with monetary experimentation in low and depressed interest rates. As we approach the end of 2016, the world does not look too different from where it started. Global growth concerns remain dominant even as the US prepares for its next monetary hike, with investors still fretting over global debt leverage, a transiting and slowing Chinese economy and the implications of Brexit on the world.

Notwithstanding these concerns, we remain optimistic on the future of Thailand, Indonesia, Philippines and Vietnam (TIPV) economies. The 2016 report card so far for TIPV is impressive, with the investment group emerging as one of the best performers within emerging markets during the year. Despite a correction in September, the TIPV equity markets are on track to end the year on a firm footing.

As we look forward to 2017, Indonesia, Philippines and Vietnam in our opinion should once again emerge as Asia's growth darlings, outpacing the developed Asia economies such as Singapore and Malaysia which continue to be plagued by the global growth slump. We believe TIPV will once again be the exciting markets to watch in 2017. Domestic resilience will be the common denominator for growth in Indonesia and Philippines while Vietnam would likely retain its title as Asia's best foreign direct investment (FDI) fuelled manufacturing export story. In all three countries, infrastructure development forms a common thread with foreign investment as key pillars of the investment story for these economies. A pro-business and pro-investment reform mindset will be the catalyst and driver to greater and more sustainable growth.

In recent months, politics has also resurfaced and dominated events in Thailand, Indonesia, Philippines and Vietnam. Thailand is in a period of mourning and transition with the passing of the highly revered King Bhumibo. He is succeeded by his son Maha Vajiralongkorn. The Philippines and Vietnam have witnessed new political leadership under President Duterte and Prime Minister Nguyen Xuan Phuc respectively while Indonesia enters its second year of political leadership under President Jokowi.

We provide an overview of political and economic developments for the TIPV markets.

Indonesia

Politics

Political change is positive and we see greater political reforms at work which could open doors for growth in investment and trade. In recent months, President Jokowi reshuffled his cabinet for the second time, and appointed the well-regarded Sri Mulyani as Minister of Finance. Indonesia also launched a 9-month tax amnesty programme, offering tax evaders low tax rates to declare previously undeclared assets. We believe this is testament that Jokowi's leadership is more secure than a year ago and we see greater prospect that he will use political capital for further bold restructuring. Investors remain strongly focused on fiscal flexibility and this has been reinforced by the commitment to remove subsidies two years ago as well as recent tax amnesty efforts. Repatriation of assets from the tax amnesty programme will help strengthen the country's balance of payments, but other long term benefits include improving the liquidity of Rupiah and widening the tax base. Investments remain critical for Indonesia as current account deficits need to be supported by FDI and we are cautiously optimistic that the government will remain committed towards greater reform and an open door policy for investment and trade.

Economy

We believe Indonesia is well positioned for economic growth thanks to tax amnesty gaining traction rapidly, and the economy being supported by higher infrastructure spending. Indonesia's tax amnesty bill approached an important checkpoint in September with penalty payments reaching IDR97trn as of end September. At 0.83% of GDP, this would be considered the most successful tax amnesty conducted globally. We believe the programme will pave the way for strong business confidence, which is essential to engineer an investment recovery as well as increasing the tax base of the economy. Monetary easing is also at hand and Indonesia remains halfway through its easing cycle. The Bank of Indonesia lowered interest rates in September to 5.0% given continued low inflation and a manageable current account deficit. The forward guidance was supportive of continued monetary easing amid the country's transformation and fiscal stimulus programme. We remain constructive on Indonesia given that the economy is recovering gradually and has further room for monetary easing due to low inflation.

Thailand

Politics

Prior to the passing of King Bhumibol on 13 October 2016, Thai politics had seen a rare period of stability since the military coup of May 2014. The military government has been able to maintain support via a series of stimulative measures for the economy, and by directly engaging the people on a path back to a democratically elected government. In particular, a referendum held in August 2016 on a draft charter, which paves the way for fresh elections, received the approval of 61% of voters.

While the King's passing introduces an elevated level of political risk, there has been no sign so far of any untoward development. Prime Minister Prayuth, in an address to the nation following the King's death, acknowledged Crown Prince Maha Vajiralongkorn as the successor to the throne. However, the Crown Prince's decision to delay the royal ascension to allow him to mourn with the people leaves room still for some uncertainty. Further on, should the Crown Prince become King, widely-held concerns over his character and close association with former Prime Minister Thaksin could remain an overhang.

Our baseline assumption is that the military government will remain in power. Indeed, the military government and Prime Minister Prayuth himself have recently been seen trying to improve ties with the Crown Prince via various activities. We also expect the government to smoothly transition to civilian rule, even though elections will now almost certainly be delayed until 2018. We would be watchful of a worsening in the relationship between the monarchy and the government, which remains the key risk.

Economy

Thailand's economic growth has seen some acceleration in 1H16, growing by 3.4% year-on-year (YoY) (Source: Bloomberg, October 2016). This has been helped by a strong trade surplus, which was boosted by weak imports, tourism growth, and a series of measures by the government aimed at stimulating consumption and investment.

Going forward, the passing of the Thai King does place some overhang on growth. In particular, the one-year mourning period, and the request to refrain from entertainment activities for one month are likely to depress consumption, particularly in discretionary items. However, we expect continued economic support from higher infrastructure spending as construction activity accelerates with the completion of bidding for Bt200b worth of small or medium-sized projects. Thailand's attraction as a tourism destination should also be resilient. Following the period of mourning we would also expect the government to continue stimulating consumption via ad-hoc measures.

In addition, the strong current account surplus has resulted in flushed liquidity conditions, which should be supportive of the stock market.

Philippines

Politics

In recent weeks, the Philippines equity market has been weak, primarily as a result of various political developments, including the potential impact of tax reform on corporates. Foreign outflows rose from US$33.7m in August to US$273.8m in September, and the Philippine peso depreciated 4.1% MoM to PHP48.50 against the US dollar (Source: Bloomberg, October 2016). S&P recently said that policy stability and predictability have diminished under President Duterte and it is also looking out for policies that will continue to stabilise the government's fiscal position over time. We believe the controversy surrounding President Duterte is not new. When President Duterte took office as the 16th president of the Philippines, his presidency was immediately overshadowed by allegations of extra-judicial killings of drug dealers and diplomatic gaffes. President Duterte's diplomacy, or lack thereof, can be frustrating from an investment perspective. However, we believe the comments and profanity underlie the strong exertion of Duterte's focus on Philippines sovereignty and nationalism. If his policies are constructively directed towards economic reforms, this could ultimately be a boon on efforts to spur domestic economic growth and spur investments and business. At this point, we do not expect the current political environment to spill over to economic reforms or have a direct impact on growth. However, we believe it is important to monitor this closely to gauge the risk that political noise starts to hurt FDI and corporate investment.

With regards to the recently announced Budget and tax reform, the Budget places strong emphasis on inclusive growth through increasing social spending (education, healthcare) as well as increasing disbursement rates. The proposed tax cuts will help boost disposable income which has been offset by higher inflation through increases in excise taxes on petroleum and food. While these measures may cause a negative impact for discretionary spending, it will be positive for consumer staples. We do not expect a significant slowdown in domestic consumption as we believe the government will help mitigate the impact through higher social spending for the lower income households.

Economy

We continue to be optimistic about the Philippines economy. 2Q2016 GDP grew at 7.0%, which was above expectations while the central bank, BSP, left policy rates unchanged with the overnight rate kept steady at 3.0% (Source: Bloomberg, October 2016). In recent months, the Department of Finance proposed a package of tax reforms, including changes to income and property taxes and new excise taxes on fuel and sugary drinks. In addition, the National Economic and Development Authority approved nine projects worth PHP171b, including a PHP75b job to upgrade the Manila Airport. This reflects a more expansionary fiscal stance and could provide upward surprises for future consumption and investment and the overall positive view on 2017 growth.

Vietnam

Politics

Vietnam completed a major political transition this year when the Communist Party of Vietnam selected a new generation of leaders for its highest decision-making bodies, the Politburo, and the Central Committee. The Party re-elected General Secretary Nguyen Phu Trong to another five-year term over the outgoing Prime Minister Nguyen Tan Dung, who was eventually ousted. While this initially worried investors because Dung was seen to be reform-minded, the move was eventually seen as one which promoted a more balanced power structure within the government, and not as one which would disrupt the country’s key growth fundamentals. We see the new government continuing in the direction of structural reform and market liberalisation, but with a more consensus-based approach, compared to the personality-driven approach taken by the outgoing Prime Minister.

Economy

While economic growth will likely fall short of the government’s target of 6.7% this year, it remained healthy at 5.5-5.9% in the first three quarters (Source: Bloomberg, October 2016). The competitive manufacturing sector, Vietnam’s key engine of economic growth, remains resilient. We expect FDI to remain robust, and exports to continue to be healthy. We expect the manufacturing activity to continue supporting income growth, which benefits demand for consumer goods and services and real estate. Financial market reforms, like the liberalisation of foreign ownership limits and a more efficient privatisation and IPO process also bode well for the stock market and economy. While the health of the banking sector remains delicate, we expect the gradual work-through of non-performing loans and recapitalisation processes to continue. We believe it is important to be watchful over rising inflation, though this remains lower than the government’s tolerance limit of 5%.

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