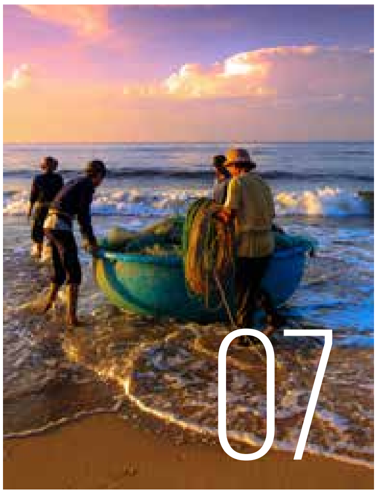
Politics, Power, and Change: What's Next for ASEAN

Table of Contents



Introduction

50 years after being founded as a political bloc of 5 Southeast Asian countries, ASEAN has evolved into a 10-member economic powerhouse. Home to some of the world's fastest growing emerging markets, the region is on course to become the 4th largest "single market" in the world by 2030. But the relatively slow pace of economic integration means that the whole is not yet greater than the sum of all the parts.

There are 10 varied and challenging national storylines unfolding in ASEAN – and businesses need to join these conversations. Juggling the many demands of an increasingly complex stakeholder universe – from consumers to politicians, regulators to society at large – will require an understanding of the wide array of domestic and regional political risks in ASEAN. While there are some challenges that are common to many countries in ASEAN, the level of risk and trend direction vary.

There are several questions on geo-strategy in the region: Will rising populism ultimately reinforce economic nationalism? Will ASEAN react to global protectionism by putting up new barriers? What will policy uncertainty and corruption mean for businesses operating in the region? What lies ahead in the next 50 years of ASEAN?

In this publication, we address some of the risks and overarching political trends that will affect government, regulation and policy in the region. What emerges through our analysis is a picture of potential: despite the geopolitical risks, new and exciting opportunities are evolving. Especially in key sectors, such as financial services, infrastructure, energy, healthcare, e-commerce, retail and real estate. Our objective is for business leaders to maintain focus on the big ideas while being aware, but not distracted, by the inevitable political squalls that come and go.

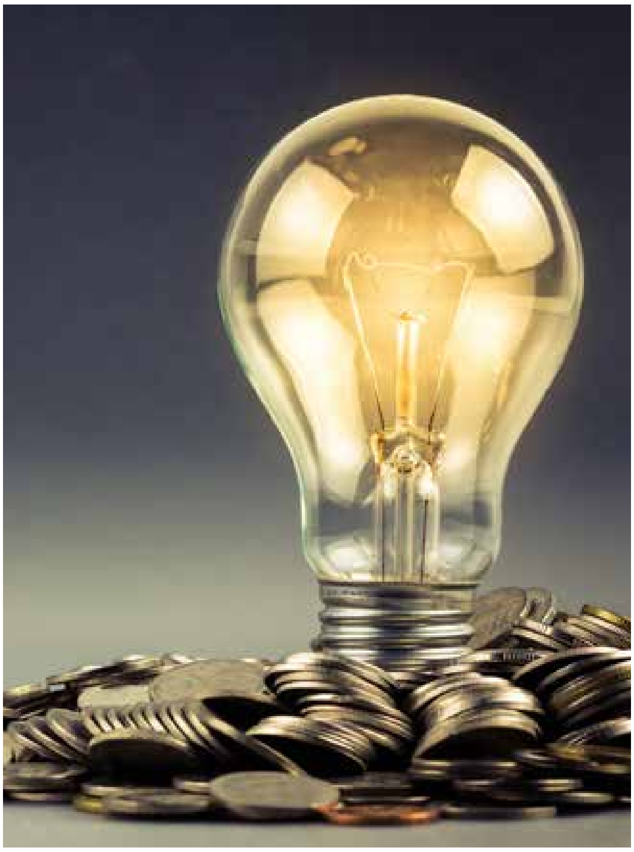
Why ASEAN matters

ASEAN is an emerging economic powerhouse. The region is home to more than 600 million people, a population larger than that of the EU. ASEAN's ten member states – Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Vietnam – are collectively equivalent to the world's sixth-largest economy, up from ninth in 2012. ASEAN's collective GDP is growing at about 5% per year and the bloc is on track to become the fourth-largest "single market" by 2030.

The region has broadly favorable demographics, which provides a strong foundation for economic growth. Most of these countries have a relatively young population, such as the Philippines, where around one-third of the population is below the age of 15. Rising incomes will lead to a growing middle class in the region, with up to 200 million more people expected to join the consuming class by 2030, offering huge untapped opportunities for businesses.

ASEAN also enjoys an enviable geostrategic location. India to the west and China and Japan to the north are vying for influence in the region, along with the US and the EU. Managed correctly, this strategic competition for influence among the different large powers stands to benefit ASEAN in terms of increased investment and support for development. ASEAN is likewise at the heart of an evolving architecture of trade agreements in the wider Asia-Pacific region. About 40% of world trade passes through the Strait of Malacca—between Indonesia, Malaysia, and Singapore—and several ASEAN countries have competing territorial claims in the South China Sea (with China and others). ASEAN as a region is critical for both trade and security.

ASEAN's members are politically, culturally, and economically diverse. Political systems include an absolute monarchy, single-party communist states, and vibrant democracies. Changing political dynamics also lead to complex and unpredictable regulatory regimes in many countries. A better understanding of these trends is therefore essential for managing risks and maximizing the huge commercial opportunity that the region offers.



Geopolitical risks: What's receding and what's rising

Geopolitical risks are hard to predict and complicated to evaluate, especially in a region as dynamic and diverse as ASEAN. But geopolitics and business risks are interconnected, often prompting shifts between power centers and impacting businesses. ASEAN offers enormous commercial opportunities but also poses a range of political risks for business and investors. An understanding of these risks, their transmission mechanisms, and how to manage them are critical to commercial success in the region.

A key external danger for business in ASEAN, as elsewhere, is **rising US protectionism.** The risk is greatest for export-dependent Singapore as well as for Malaysia and Vietnam, who are also members of the Trans Pacific Partnership (TPP), from which the US has withdrawn. But the potential rise in broader US protectionism could have a big impact on exporters, across the region.

Recent developments in Indonesia and Malaysia have highlighted the **growing role of religion in influencing political processes and outcomes.** This trend gained strength ahead of elections in these countries and could subside afterwards, though structural drivers, especially growing concerns over inequality, are expected to remain. This could influence legal processes and will have an impact on regulations affecting the food and beverage, entertainment, tourism, retail, and e-commerce sectors in particular.

Populism has manifested in different forms. For example, in the Philippines the election of President Duterte was on an anti-establishment and anti-drugs agenda. Politics driven by predominantly populist agendas will also have an indirect impact on business, through shifting demands on government spending priorities and a decreased appetite for difficult structural reforms. But not all ASEAN countries are experiencing rising populism.

There are concerns that protectionism and economic nationalism are increasing ahead of the general election in Malaysia and this remains a moderate risk in most ASEAN countries. **Policy uncertainty** is also a moderate risk for most countries, particularly in Indonesia and the Philippines. **Corruption** continues to be a problem in the region too.

The risk of terrorism is also present, primarily in the transportation, tourism, retail, hospitality and infrastructure sectors. The other key security threat is **cyber-crime,** such as theft of intellectual property and data, as online activity in the region increases. In ASEAN, Singapore is establishing itself as a leader in cybersecurity but several other countries are not yet fully-equipped to handle this growing threat.

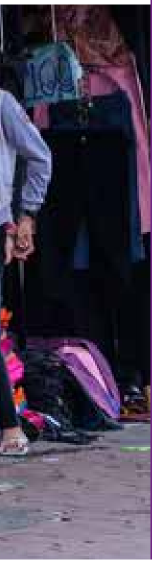
One security risk that is receding is tensions in the South China Sea, following President Duterte's warming ties with China.

The shifting sands of the ASEAN geopolitical landscape

ASEAN countries feel greater uncertainty following the election of US President Donald Trump. This includes uncertainty around evolving US trade and security policy toward the region. Most notably, US withdrawal from the TPP is particularly concerning for the four ASEAN nations that are participating in the trade accord – Singapore, Malaysia, Vietnam, and Brunei. These countries, along with the other remaining TPP members, have agreed to explore the possibility of pushing ahead with the pact without the US. Countries, such as Indonesia and the Philippines, which resisted joining the pact may be relieved that US pressure to join is now gone, along with arguably reduced competitive advantages for TPP members if the pact is implemented without its largest member, the US. However, rising US protectionism will remain a concern.

ASEAN will respond to changing US trade policy by strengthening ties with other markets. This will probably include placing more importance on the proposed Regional Comprehensive Economic Partnership (RCEP) which brings together ASEAN and its six free trade agreement (FTA) partners: China, Japan, South Korea, India, Australia, and New Zealand. The 16 countries collectively account for nearly half of the world's population and about 30% of global GDP and trade. RCEP is less ambitious than the TPP in terms of tariff reduction, services, and investment liberalization. While RECP addresses important issues such as intellectual property, competition policy, and e-commerce, these chapters are likely to be less rigorous than those that were agreed upon under the TPP. RCEP prioritizes inclusiveness and flexibility over ambition, allowing differentiated terms for countries at different development levels.

Changing political and economic dynamics now broadly progress on RCEP. This year marks the 50th anniversary of ASEAN. Announcing the conclusion of RCEP would be a fitting celebration at the leaders' summit in November. China could also play a more active role in driving forward the trade pact, seizing the strategic opening created by US withdrawal from the TPP and bolstering President Xi Jinping's claim to be the new leader of globalization. US withdrawal from TPP likely makes the RCEP economically more important for the seven countries that are participating in both pacts – Japan, Australia, New Zealand, Singapore, Malaysia, Vietnam, and Brunei. Weighed against that, effports to move forward as the "TPP-11" (minus the US) could take political attention away from the RCEP. Even if, on balance, there are now stronger political tailwinds behind RCEP, completeing all the technical negotiations by the end of 2017 will be an enormous challenge, given the diverse development levels of the member countries.



Significant macro trends in the region

Structural reforms are necessary to unlock faster and more sustainable economic growth. The region has weathered the subdued global economy due to robust domestic demand. But some of the pillars of this domestic demand are starting to weaken. There is high household debt – for example, in Malaysia – constraining the growth of consumer spending. Governments in Vietnam, Malaysia, and Indonesia are having to tighten their fiscal belts to stay within government deficit and debt limits by cutting spending and/or raising taxes. This situation increases the urgency of implementing reforms that will boost private sector investment and export competitiveness. This could also mean a relatively bigger political push behind measures to improve the business environment, as well as modest steps to liberalize foreign direct investment (FDI) in some key sectors.

If the remaining 11 members of the TPP succeed in implementing the deal, it would be a strong external driver of reform. Countries participating in the trade pact have had to make a series of tough reform commitments. The threat of loss of trade and FDI for countries outside the TPP agreement will help to drive reform across the region (though this effect will be weaker without US involvement); the RCEP will likely be a less significant catalyst for change.

EU FTAs are also key external drivers of reform, setting a high bar for trade liberalization agreements alongside the TPP. The EU has already concluded FTAs with Singapore and Vietnam, though these have yet to be implemented. Recently launched EU negotiations with Indonesia and the Philippines could slowly help spur reform in these countries. An EU-ASEAN FTA is on the agenda but remains years away.

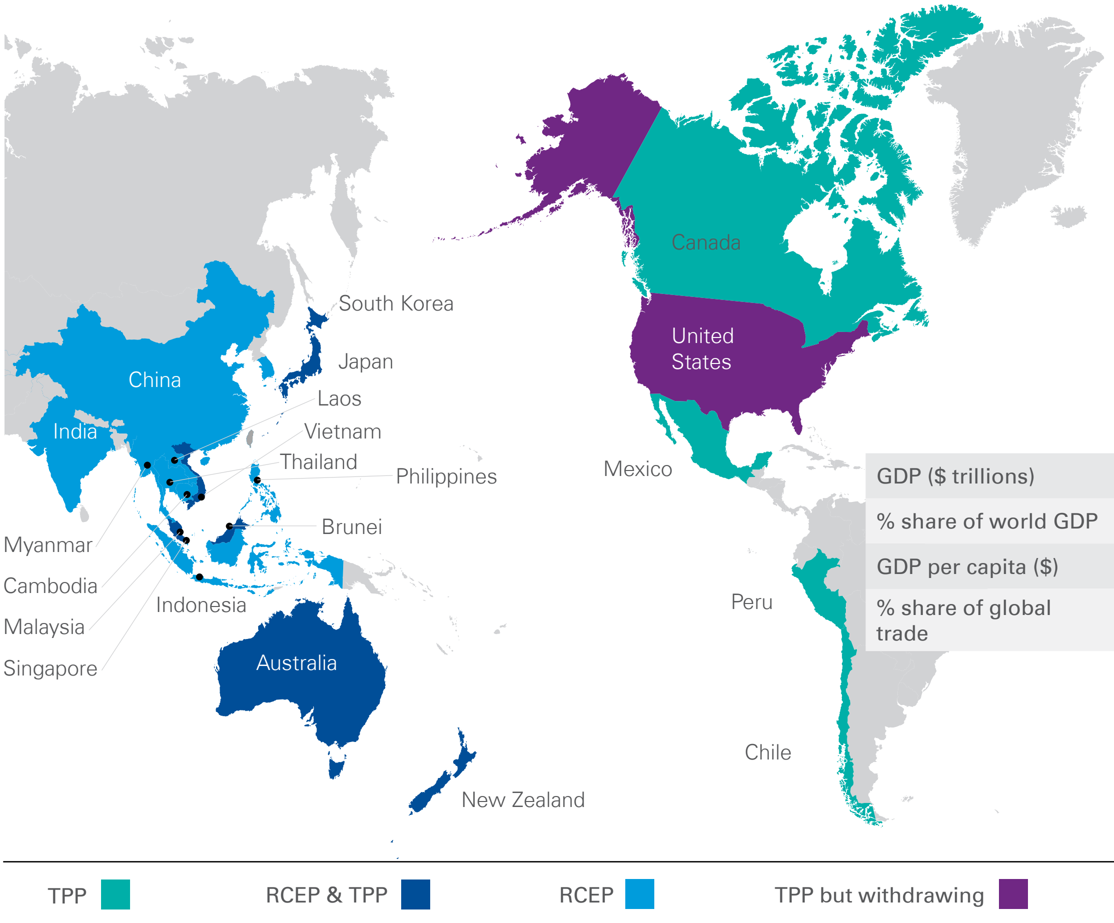
Urbanization will continue to be a key trend in ASEAN. More than 20% of ASEAN's total population lives in cities of more than 200,000 people, and more than 50 million are expected to move from rural to urban areas by 2025. Rapid urbanization in the region is likely to support employment, rising incomes, and access to better public services. But unplanned urbanization could also exert further pressure on the region's creaking infrastructure.

Populist politicians are tapping into concerns about rising social and income inequality. While there has been a substantial reduction in the absolute level of poverty across the region – the share of the population below the international poverty line ($1.25 a day) fell from 14% in 2000 to 3% in 2013 - the gap between the richest and poorest has widened in many countries.

Corruption remains a major impediment to the creation of a level playing field for businesses in much of ASEAN. Seven of the ten ASEAN members rank in the bottom half of Transparency International's Corruption Perceptions Index. Though most governments have made tackling corruption a priority, this will remain a notable risk for businesses operating in the region.

The threat to jobs from automation could exacerbate social and income inequality, resulting in more populist political responses. The International Labor Organization predicts that automation could potentially affect up to 56% of overall employment in five ASEAN economies over the next two decades. Governments will need to balance profitability and competitiveness with high levels of employment.

TPP and RCEP members



	TPP	RCEP
GDP ($ trillions)	28	22.6
% share of world GDP	36.3	29.2
GDP per capita ($)	34,821	6,539
% share of global trade	25.3	28.4

Source: Eurasia Group

RCEP will represent a further strengthening of ASEAN's links with Beijing. ASEAN stands to benefit from China's One Belt One Road (OBOR) initiative and needs the investment and export demand that China can provide. That said, most ASEAN countries still want an actively engaged US, which will make it tricky to balance relationships with Washington and Beijing. Countries in the region are also balancing their economic and trade relations with China and Japan, most notably in the infrastructure sector.

South China Sea tensions are easing due to President Duterte's warmer ties with Beijing. China's militarization of the South China Sea and the threat to freedom of navigation and overflight remain a concern for most countries in the region, not just for those that have territorial disputes with China. It is especially important for ports, such as Singapore, that could be harmed economically if shipping flows through the region were curtailed. Several countries are bolstering their defense and power projection capabilities. There may be more skirmishes, but the risk of intentional conflict remains low.

The threat of terrorism in ASEAN is likely to intensify in 2017 because of geopolitical developments. This will place an increasing strain on security services in ASEAN countries. ASEAN has promoted regional anti-terror cooperation, ratifying the ASEAN Convention on Counter-Terrorism in 2013. But ASEAN's limited institutional infrastructure could hamper the efficacy of this convention.

States must also grapple with rising cyber threats. Singapore is focused on cyber risks, establishing the Cyber Security Agency in 2015, Defense Cyber Organization in 2017, and hosting Interpol's global cybersecurity headquarters. The head of the Monetary Authority of Singapore (MAS), Ravi Menon, recently warned that the next global financial crisis could be caused by a cyber-attack. But most countries in the region are still not fully-equipped to handle this threat and will need to invest substantially more in cyber defenses.

ASEAN struggle to form a common position on security issues, especially regarding the South China Sea, will continue. The bloc has been unable to agree on a stance on territorial disputes and China's expanding military presence in the South China Sea. According to China, a first draft of the ASEAN-China Code of Conduct in the South China Sea has been approved but negotiations have not yet been finalized.

ASEAN integration will continue to proceed slowly. The ASEAN Economic Community (AEC) was officially launched at the end of 2015, representing an important step forward in the long process of regional integration. ASEAN has made great strides in reducing tariffs between member countries but the failure to address non-tariff barriers has deterred the increase in intra-ASEAN trade. While incremental progress has been made on services and investment integration, labor mobility is still a sensitive issue. The elements of the AEC 2015 agenda that were not completed on schedule were wrapped into the successor AEC 2025 agenda, which aims to continue integration. Priorities include addressing non-tariff barriers, improving regulatory harmonization and strengthening infrastructure connectivity among the ASEAN members. But questions remain over the AEC's ability to deliver a seamless economic bloc.

The risks outlined are high and/or rising in several countries but they are low and/or falling or stable elsewhere. Geopolitical trends and dynamics in the region are also creating exciting new growth opportunities for companies, which vary by country and sector.

Implications for core sectors

> **"Social mobility and income inequality in the region makes promoting greater financial inclusion that much more important. In less developed economies, where basic financial infrastructure is lacking and branch banking is inconvenient for many, new channels such as mobile banking may be the answer. We expect to see greater demand for a wider range of financial products, owing to the rapidly growing middle class here in ASEAN."**
>
> **Leong Kok Keong**
> Partner and Head of Financial Services,
> KPMG in Singapore

Financial services

Governments are aware of the need to deepen financial markets to improve economic efficiency and make growth more sustainable. Progress varies by sector and country. The banking sector is relatively well developed and capitalized in ASEAN and large infrastructure spending across the region is helping to create further growth opportunities. Countries such as Indonesia and Vietnam will continue to reform their sovereign debt markets to improve liquidity and, hopefully, lower yields/borrowing costs. Corporate bond markets remain relatively small in ASEAN, but there are good prospects for reform in this area because it is not politically sensitive and authorities recognize the importance of reducing the overreliance on bank finance.

Public concern over rising income inequality is making greater financial inclusion a political priority across the region. In less developed economies, where basic financial infrastructure is lacking and branch banking is inconvenient for many, new channels such as mobile banking will proliferate. The rapidly growing middle class in ASEAN will lead to rising demand for a wider range of financial products.

The region is also underinsured. This is especially true for lower and middle income countries in the region. For example, according to the OECD, the insurance penetration rate, which is the level of insurance premiums relative to GDP, was 1.6% in 2015 in Indonesia compared with 8.3% in Singapore. This sector offers huge growth potential. However, the political impetus behind insurance is mixed and often, the sector does not receive the attention it deserves. However, recent natural disasters (like in the Philippines) have highlighted the need to address this problem. The swelling middle class will also be a key driver of growth for the insurance sector.

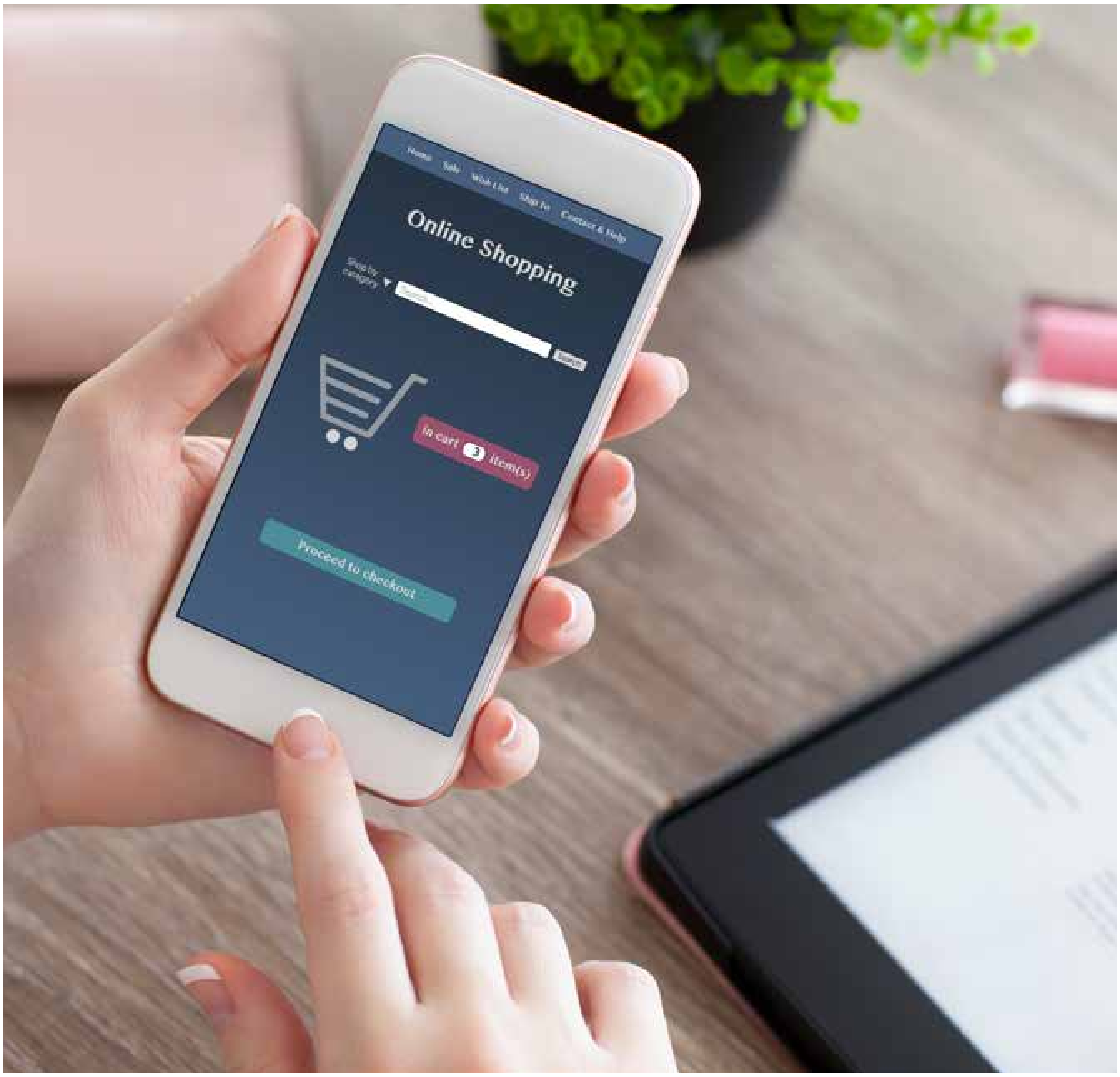
Regional financial integration is gradually progressing. Significant progress has been made in capital markets, guided by an active and competent ASEAN working group, the ASEAN Capital Markets Forum. This area is less politically sensitive than banking integration, which has made only marginal progress through the ASEAN Banking Integration Framework.

ASEAN countries are embracing the opportunities of financial technology (fintech). Singapore is actively pushing fintech as part of its CFE agenda, forming cooperation agreements with London, the leading fintech hub in Europe. MAS has enacted several regulations last year to expand the industry, such as, a sovereign digital currency pilot scheme and a fintech regulatory sandbox. There is also strong political support for fintech in Malaysia and Vietnam.

E-commerce

Some of the world's emerging markets with the most rapidly expanding online activity are in ASEAN. Indonesia already has the third-largest number of Facebook users. Indonesia, the Philippines, and Vietnam are expected to be among the top 15 smartphone markets in the world by 2020. But despite the high proportion of ASEAN population with access to the internet and smartphones, the online marketplace remains rather small overall, owing to restrictive regulations and poor logistics infrastructure. There is also a perceived risk of making payments online in the current the legal environment. Even in high-tech Singapore, online retail comprises only 4%-5% of all sales while the figure is about 1% in other ASEAN countries.

Countries including Singapore, Indonesia, and the Philippines are pushing the digital economy agenda. Singapore has launched education programs to foster digital talent and encourage SMEs to create online retail offerings. In the rest of the region, limited e-commerce presence is due to modest network coverage, slow internet speeds, and the high connection costs. But there has been a push by many governments to develop and improve internet infrastructure. Indonesia has invested in connecting its eastern islands to the country's internet network and is planning a nationwide fiber-optic network. This is one of the more promising areas for PPPs in the region, as evidenced by Indonesia's nationwide fiber-optic network—one of the few infrastructure projects there to successfully involve the private sector.



Infrastructure

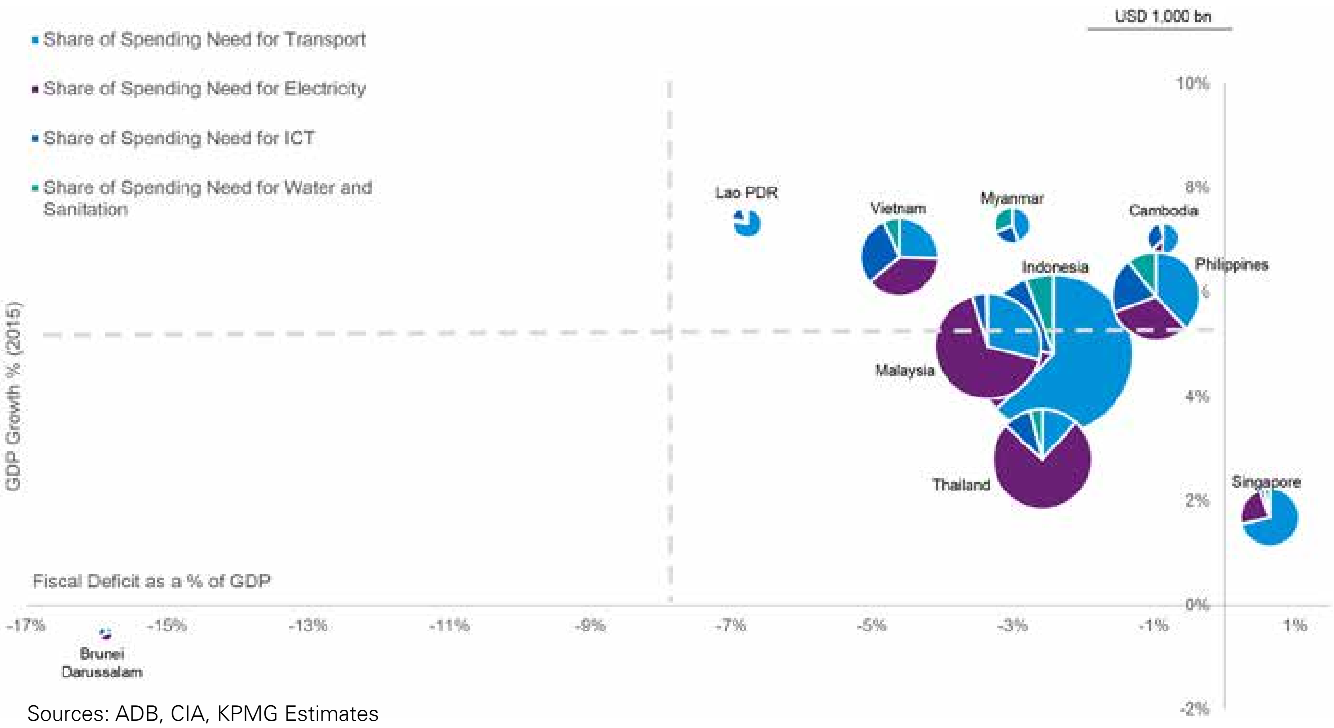
The region's infrastructure is under pressure due to growing populations and rising urbanization. The Asian Development Bank estimates that the region must spend at least $60 billion a year on infrastructure upgrades – not only transport but also power, water, energy infrastructure, and broadband. Governments in ASEAN countries are planning to implement these upgrades; Indonesia alone intends to spend $425 billion on infrastructure over five years. But these plans have faced some technical, institutional, and capacity constraints that have hampered execution. Greenfield infrastructure investments have previously suffered from uncertain policy framework, lack of political prioritization, and limited capacity in government institutions. Yet economic and political dynamics now favor faster progress. An uncertain global economy and the threat of US protectionism makes infrastructure's role in supporting economic growth more critical.

Governments and SOEs will lead the infrastructure push. More fiscally constrained countries, such as Vietnam, Malaysia and Indonesia, are introducing measures to raise more revenue which could enable more funds to be channeled to infrastructure. But government monopoly on infrastructure development in many countries is arguably unsustainable and has led to insufficient focus on the long-term cost-benefit analysis of projects.

ASEAN countries are also eager to rely more on PPP to reduce the fiscal burden on the state. But progress has been mixed and there is a risk of programs falling short of expectations in some counties. The Philippines has the most advanced PPP program. Governments in Indonesia and Vietnam have expressed a desire to ramp up the use of PPPs but have not yet developed a solid pipeline of projects. Following the return of reform-minded Sri Mulyani Indrawati as finance minister, prospects have improved in Indonesia. Singapore and Malaysia will continue to prefer drawing on state budgets and state-linked companies to build infrastructure.

China and Japan, and to a lesser extent South Korea, are playing an ever-increasing role in filling the funding gap. Infrastructure is the area where these two Asian powers competition for strategic and commercial influence is most obviously playing out. China is focused on rail links between its southern city of Kunming and bordering ASEAN countries. The aim is to make it easier for Chinese companies to shift production facilities to ASEAN and tap its low-cost labor supply, to sell Chinese rail technology and goods to rapidly growing ASEAN nations, and to access ports in countries that offer reduced shipping times to the Middle East, Africa, and Europe. Japan is more focused on improving road and rail links within the Greater Mekong sub-region, running east-west across mainland ASEAN, and improving links between Japanese production facilities in the region. Both China and Japan are supporting infrastructure demands in maritime ASEAN as well. ASEAN is expected to be a big beneficiary of lending from the China-led Asian Infrastructure Investment Bank (AIIB); financing from the Asian Development Bank (ADB) and World Bank will continue.

Total Infrastructure Spending Needs in ASEAN 2016-2030 (in 2015 USD)



Sources: ADB, CIA, KPMG Estimates

Healthcare

Demand for healthcare in the region is increasing rapidly because of growing populations, longer lifespans, and rising affluence. Public healthcare spending has traditionally been low in ASEAN, which has led to a proliferation of private providers. Vietnam spends the most overall on healthcare relative to the size of its economy, with public and private spending amounting to 7.1% of GDP in 2014 according to the World Bank. Over half of this was government spending. The Philippines spend 4.7% of GDP on healthcare, with around a third coming from government. Among the region's major economies, healthcare spending is the lowest in Indonesia, at 2.8% of GDP with a third of this by the government. Addressing this shortfall has become an important political priority for President Jokowi's government, so there is upside potential in the healthcare sector there.

Countries are relaxing laws on private healthcare to entice investors to complement public sector offerings. For example, in Indonesia, there has been a push to revise the Negative Investment List to allow more FDI; that ties in with a target set in 2014 to have all Indonesians receive basic universal health coverage by 2019. Several countries are also eager to explore the use of PPPs to expand healthcare provision.

Growing and ageing populations, combined with expanding provision of healthcare, will lead to rapid growth in pharmaceuticals consumption. This sector is likely to remain subject to trade restrictions and weak enforcement of intellectual property in some countries though, given the governments' desire to support domestic production of generic pharmaceuticals. Excessive use of antibiotics will remain a problem, contributing to growing concerns about anti-microbial resistance.

"One of the greatest challenges ASEAN is facing today is providing timely, efficient, effective and economically viable infrastructure to its people. There are a number of realities, trends, and constraints that will determine how well we meet this challenge."

Satya Ramamurthy
Partner and Head of Infrastructure, Government & Healthcare, KPMG in Singapore

Energy and natural resources

Meeting energy demand will pose a key challenge and significant risk to the longer-term growth outlook. There are an estimated 120 million people living in energy poverty in ASEAN, lacking access to electricity or clean cooking fuel. The International Energy Association estimates that Southeast Asia's energy demand will grow by 80% from 2015 to 2040, given rapid economic expansion, rising incomes, industrialization, and urbanization. Oil demand is predicted to climb by nearly 50% over the same time frame, with newly-affluent ASEAN populations buying more cars. Natural gas use will grow by almost two-thirds owing to more industrial demand. Electricity demand will almost triple. Fossil fuels such as, oil, gas and coal, will remain dominant in the energy mix as countries seek to meet the rapid growth of domestic consumption.

Countries are planning to increase imports in the short term to meet energy demand, while also building domestic capacity (which will take time). By 2040, the region's net oil imports will more than double and cost will surge to over $300 billion per year. Production will also be increasingly consumed within the region instead of being exported.

The greatest growth in energy demand is likely to come from Vietnam. The healthy prospects for its manufacturing sector make boosting the supply and reliability of power generation a priority. Vietnam has most actively explored the potential for nuclear power generation, with question marks over security implications and who would supply the technology. Indonesia might encounter localized energy shortages in parts of the country where it lacks substantial infrastructure. Malaysia too faces the risk of shortages given the progressive decline of gas fields that meet much of the demand from industry. Energy companies are seeking to build improved infrastructure for gas/LNG as part of the fuel mix, including to replace the use of diesel.

The growth in energy demand in the region bodes well for Singapore, which remains a major commodity and energy trading hub for Asia. Plans for increased energy connectivity among ASEAN members remain difficult. This includes the proposed Trans-ASEAN Gas Pipeline, on which progress has been limited. The Laos hydro "battery for ASEAN" project signed with Thailand, Singapore and Malaysia also demonstrated the political and technical complexities of intra-regional energy agreements.

"The region is seeing a growth in demand for energy and this bodes well for Singapore, which remains a major commodity and energy trading hub. What is more difficult is increasing energy connectivity between ASEAN members on a multilateral basis and building infrastructure to improve the choice of fuels, including gas, in the energy mix."

Brett Hall
Partner and Head of Energy & Natural Resources, KPMG in Singapore

The natural resources sector remains politically sensitive, especially in Indonesia and the Philippines. The recent unwinding of the ban on unprocessed mineral exports in Indonesia was a step in the right direction, though the dramatic changes and reversals in policy in recent years have damaged the industry. Philippines has taken steps to close several mines that failed environmental inspections. The country has also canceled mineral production-sharing agreements. Both moves have upset mining groups but have been welcomed by the public.

Public concerns over pollution and environmental degradation in the region have added to political pressure to address these issues. International commitments made in the Paris Agreement also add to the pressure. Pollution created by fires used to clear palm oil plantations in Indonesia regularly leave Singapore and parts of Malaysia covered in a blanket of haze. However, progress on addressing trans-boundary haze pollution within ASEAN has been limited.

The demand for renewables appears set to more than double in ASEAN by 2040, underpinned by strong policy support. Singapore is the only ASEAN country with concrete plans to implement a carbon tax, which will take effect in 2019. The tax will be $7–$14 per ton of emissions of carbon dioxide and five other greenhouse gases, which would raise electricity costs by 2%-4%. The impact will be the greatest on heavy industrial users, such as oil refineries. Although there is currently less political will to introduce carbon taxes elsewhere in the region, several countries are actively promoting the development of green finance to channel more investment into environment and climate friendly projects. The ASEAN Capital Markets Forum is working to introduce regional green bond standards which would apply across ASEAN's capital markets.

Real estate

Rapid urbanization will fuel housing demand growth. As the relatively young population in ASEAN move from rural to urban areas in pursuit of better opportunities, the demand for housing stock in urban areas will rise. About five million people are expected to move from rural to urban areas across ASEAN each year over the next decade. This will place a greater strain on infrastructure and result in significant price movements in the housing market. Governments will need to respond to the potential stress on public services and social cohesion stemming from overcrowding and a lack of affordable housing options. Indonesia, Vietnam, and the Philippines are experiencing the highest levels of rural-urban migration and will therefore experience the greatest growth in housing demand, particularly affordable housing.

Rising incomes should boost consumer spending and support growth in retail offerings. The creation of new and better paying job opportunities is likely to result in a larger and more affluent middle class with greater propensity for consumption. In response, more retail space in both central and suburban areas may be required to house consumer-focused businesses, even as internet shopping becomes more prevalent. Many retail malls are exploring moving toward a more family-oriented shopping and recreation experience to attract crowds. While slower real wage growth could be expected in countries such as Malaysia and Singapore the burgeoning middle class in faster growing countries such as Cambodia, Laos, and Vietnam should see rising disposable incomes that will probably boost consumption and retail development.

Economic growth has a multiplier effect on demand for commercial and industrial space. With many ASEAN countries experiencing strong economic growth, businesses will need more commercial and industrial space as they continue to expand output and production. Manufacturing businesses will require more factories and warehouses while service businesses will require more office space for their growing staff base. Cross-border investments will further drive growth in this segment as businesses from more developed countries seek to capitalize on the lower cost base in developing ASEAN countries. As rising costs erode the profitability of manufacturing businesses based in Singapore and market sentiment remains relatively pessimistic across all real estate segments in the near term, these companies have increasingly turned to countries, such as Cambodia, Indonesia, Malaysia, and Vietnam, as viable alternatives.

Political instability and lack of clarity over property rights may stifle sustainable growth in developing real estate markets. Many ASEAN countries have taken steps to liberalize their real estate markets by easing foreign ownership restrictions, and foreign players are now able to participate as investors and developers. But if policies on issues such as the period of foreign ownership and lease extension costs lack certainty and clarity, short-term speculative activity rather than steady long-term investment may result. Political instability may further compound volatility in the real estate market if investors are scared away. For example, the recent political uncertainty in the Philippines has had a dampening effect as foreign investors become more cautious toward the country.

"The real estate sector is going through a period of reform. Recently, several ASEAN countries have relaxed their restrictions to foreign ownership, though the breadth of property rights is sometimes unclear. But the market is trending toward liberalization, presenting some very interesting opportunities for the long as well as short term."

Tay Hong Beng
Partner and Head of Real Estate,
KPMG in Singapore

Retail and consumer goods

Indonesia, the Philippines, and Vietnam offer the most attractive consumer markets. All three have large and urbanizing populations, rapidly rising incomes, and low levels of household debt. In the Philippines, consumption is also buoyed by high levels of remittances from overseas Filipino workers, amounting to $27 billion in 2016. Consumer spending is expanding at a rate of over 6% per annum in the Philippines and Vietnam and around 5% in Indonesia. These rates look sustainable due to the factors mentioned above. These three countries all rank in the top five globally in the latest Nielson Consumer Confidence Index. The growing middle class will spur growth in subsectors such as fast-moving consumer goods, fashion, and food and beverage. The share of retail sales taking place online will grow albeit from a relatively low base.

Political factors continue to shape the retail landscape. International retailers have made inroads into ASEAN, including supermarkets and shopping malls in addition to leading global fashion brands. But full liberalization of the retail sector is made more politically difficult in many countries in the region by concerns about the socioeconomic impact on small family retailers, as well as on larger vested interests. Potential political risks in this sector also include rising populism in Indonesia and Malaysia, which could lead to further restrictions in these countries (for example, on alcohol sales and halal requirements). Counterfeiting remains a serious threat in several countries as well. Intellectual property protection policies and laws are strengthening but the political and administrative commitment to fully implementing these laws remains patchy.

Evolving fiscal policy frameworks will also impact the retail sector. As governments respond to populist pressure for increased spending on public services and social welfare they will need to boost fiscal revenue. Raising income tax is politically more difficult so import taxes on luxury items are likely to remain high and governments may raise or introduce other taxes which would have an impact on the retail sector, as Malaysia did by introducing the Goods and Services Tax.

Conclusion

These are exciting times for ASEAN: rapidly growing economies, an expanding middle class and the stimulus of an ASEAN economic community are calling for business to take advantage of the enormous potential of the region. But the opportunities here also come with a wide array of political risks. The external and domestic political trends in ASEAN affect policy and the regulatory environment for specific sectors. Businesses who have the greatest understanding of this interplay will find themselves stronger, more competitive, and socially relevant.

Politics, Power, and Change: What's next for ASEAN is a publication written by **Peter Mumford, Director, Asia, Eurasia Group** and **Satya Ramamurthy, Partner and Head of Global Strategy Group, KPMG in Singapore.**

Contributors to the development of this publication include **Leong Kok Keong, Tay Hong Beng, Brett Hall, and Tim Rockell** of KPMG in Singapore.

The authors would like to thank the Managing Partners of KPMG member firms in ASEAN for their contributions.

Managing Editors: **Sreetama Ray, Low Pui Leng**

Art Direction and Design: **Sam Wong, Nicholas Lee**

For media queries, please contact
KPMG: **kelvinlee1@kpmg.com.sg**
Eurasia Group: **media@eurasiagroup.net**

For assistance with marketing or permission to republish, please contact **asean@kpmg.com.sg**

KPMG in Singapore and Eurasia Group have jointly published this report to provide clients with unique insights that combine Eurasia Group's forward-looking analysis of political developments with KPMG's expertise across audit, tax, advisory and company-level business implications.

Contact us

KPMG

Eurasia Group

Satya Ramamurthy
Partner and Head of Global Strategy Group
T : +65 6213 2060
E : sramamurthy@kpmg.com.sg

16 Raffles Quay #22-00
Hong Leong Building
Singapore 048581

T : +65 6213 3388
E : asean@kpmg.com.sg

www.kpmg.com.sg
kpmg.com.sg/socialmedia

Peter Mumford
Director, Asia
T : +65 6679 6270
E : mumford@eurasiagroup.net

138 Market Street
24th Floor CapitaGreen Building
Singapore 048946

www.eurasiagroup.com
@EurasiaGroup