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Unleashing ASEAN's potential through AEC

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UNLEASHING

ASEAN's potential through AEC

Rising affluence and an expanding middle class, accompanied by a demographic dividend and an abundance of resources, will see ASEAN become one of the world's largest integrated economic communities.

By Michael Zink

The Association of Southeast Asian Nations (ASEAN) has set an ambitious goal to integrate the economies of its ten members by 2015, a move that is aimed at boosting the bloc's competitiveness and creating development across the region that is more equitable. With the target date for Southeast Asia's countries to create a single economic market just months away, increasing attention is being paid to the region's vast economic potential.

If successful, the formation of the ASEAN Economic Community (AEC) will not only create one of the world's largest integrated economic spheres, but will add vastly to the appeal of a region that is already benefiting from a trio of powerful global trends: globalisation, urbanisation and digitisation.

In an increasingly connected world, multinational companies are flocking to set up manufacturing and service hubs in Southeast Asian countries in an effort to better service Asia and the rest of the world. A case in point: in its annual ranking of the top 2000 public companies in the world, Forbes reported that the number of Global 2000 companies with headquarters in ASEAN increased from 49 in 2006 to 74 in 2013, a gain of just over 50 percent in seven years.

McKinsey also stated in its 2014 report, "Understanding ASEAN: Seven Things You Need to Know" that 227 businesses with more than US$1 billion in revenues, or three percent of the world's total, are located in this part of the world. These numbers all point to ASEAN's attractiveness as a place to conduct business on a global scale.

Meanwhile, growing urbanisation is leading to rising consumption—and hence economic growth—as more people in Southeast Asia start to seek their fortunes in the region's booming urban centres. The McKinsey report observes that roughly 22 percent of ASEAN's population currently lives in cities of more than 200,000 inhabitants, accounting for more than 54 percent of the region's GDP. This trend is expected to continue, with McKinsey expecting another 54 million people to migrate by 2025.

The region's consumers have also adopted digital technologies at a rapid pace, helping to fuel consumption and growth. According to the McKinsey report, mobile penetration in ASEAN stands at 110 percent with Internet population at around 25 percent. Advanced Singapore is the front-runner in this area, boasting the fourth-highest smartphone penetration in the world: almost three in four Singaporeans are connected to the Internet.

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If viewed by sheer numbers alone, Indonesia is poised to become a digital powerhouse. It is Southeast Asia's most populous country and its largest economy. It already has 282 million mobile subscriptions with 100 million Internet users forecast by 2016. Internet users in the region are also actively engaging with one another on social media platforms like Facebook, where they make up the second-largest community after the United States.

A region brimming with potential

ASEAN's economic potential is linked to, among other factors, its size, the potential of its capital markets and a robust credit environment. According to the ASEAN Economic Community (AEC) Chartbook 2013, the region's collective population grew from 534 million in 2002 to 617 million in 2012, making it the third largest in the world after China and India. The population grew at an average annual rate of 1.45 percent over the same period, faster than China's 0.53 percent and India's 1.44 percent.

ASEAN POPULATION

534 MILLION in 2002

617 MILLION in 2012

Southeast Asia's sizeable youth population is also producing a 'demographic dividend', a situation where fertility rates fall, which in turn results in a labour force that is temporarily growing faster than the population dependent on it, and frees up resources that can boost future economic growth. This is most evident in Indonesia, where more than half of its 240 million people are under the age of 30.[i]

When viewed as a single economic entity, ASEAN last year ranked as the seventh largest economy in the world with a combined GDP of US$2.4 trillion, according to a 2014 report by UNCTAD. It is expected to grow to become the fourth largest by 2050, according to global consultants IHS.

The region's biggest economies—Indonesia, Malaysia, the Philippines, Singapore and Thailand—have seen their per capita GDP expand two to four times, according to Citi Research. The combined GDP of the ASEAN-5, which includes the Philippines, Indonesia, Malaysia, Thailand and Vietnam, is US$2.1 trillion.

This GDP growth has also been accompanied by rising affluence as more people work their way into the middle class. Research firm Nielsen estimates that there were over 190 million people in Southeast Asia who could be defined as middle class in 2012, with this number expected to double to 400 million by 2020.[ii] This shift bodes well for the region's future prospects.

ASEAN's capital markets have also grown rapidly in the past decade, providing a platform for businesses here to fuel their growth. The number of mergers and acquisitions has more than quadrupled over the past ten years, while other barometers such as stock market capitalisation, local currency debt outstanding and foreign portfolio investment have all risen faster than the rest of the world. Market capitalisation of the ASEAN-5 stock exchanges has quintupled to US$2.5 trillion since 2000, representing more than 100 percent of their combined GDP.

Reflecting this trend, Singapore overtook Japan last year for the first time as Asia's biggest foreign exchange centre. In April 2013, the Bank for International Settlements Triennial Central Bank Survey released statistics showing that the city-state's average daily foreign exchange volume increased 44 percent to US$383 billion in April 2013, compared to the same period in 2010. Moreover, in an encouraging sign of co-operation among member nations, the Monetary Authority of Singapore, the Securities Commission of Malaysia and the Securities and Exchange Commission of Thailand, jointly rolled out the ASEAN Collective Investment Scheme (CIS) Framework in August this year.

This initiative gives retail investors from these countries a wider choice of funds to invest in, while fund managers will have better access to investors in other ASEAN countries. The move is expected to deepen the region's capital markets and boost liquidity.

Banks are also keen to lend to companies in Southeast Asia, drawn by robust demand for credit as well as the improved credit worthiness of borrowers here. The region's bank credit to GDP percentage remains relatively low, while non-performing loans as a percentage of total loans in ASEAN banks have been declining.

Taken together, these factors are leading to a more sanguine outlook for the region compared to many parts of the world. According to the 2015 ASEAN Business Outlook Survey, two-thirds of the 588 respondents expect ASEAN markets to become more important in terms of their companies' worldwide revenue over the next two years. Nine out of ten respondents also expect their company's level of trade and investment in Southeast Asia to increase over the next five years. Meanwhile, the survey also revealed that 81 percent of executives across the region expect an increase in profits in 2015. With US$204 billion invested in ASEAN, U.S. companies are collectively the largest direct foreign investor in the region.

The AEC game changer

Looking ahead, the formation of the AEC is a major milestone in ASEAN's development as an economic community, and one that will create synergies and generate new opportunities for regional businesses.

CITI'S STRATEGIC POSITIONING IN ASEAN

Having a large and established franchise in the region, Citi is an example of a company that is well positioned to capitalise on ASEAN's future growth, and to contribute to the development of the region. The bank has been operating in Southeast Asia since 1902 and is deeply entrenched in its various markets.

Over the years, Citi has built a number of strategically important hubs and Centers of Excellence for its various businesses, including an Operations and Technology support centre in Singapore that serves more than 60 countries around the world, and a trade processing centre in Malaysia that offers its services to Citi Asia. Reflecting its importance, around 30 percent of Citi Asia employees live and work in Southeast Asia. On the client-facing side, the bank has extended its reach by serving the local and regional offices of its multinational clients in ASEAN markets. Meanwhile, specialised divisions such as Citi Private Bank Asia and Citi Commercial Bank Hub have been bolstered with the necessary resources and talent to serve their respective customer segments.

Citi is also playing a role in banking innovation in ASEAN. For instance, the Consumer Innovation Lab that is housed in Singapore played a key role in the development of Citi's Smart Banking branches and the new generation of ATMs called Citibank Express. On the corporate side, the Citi Innovation Lab, which has been operational since 2011, leverages analytics and interactive technologies to engage with Citi's corporate and institutional clients and create effective solutions and products for them. At the time of the launch, the lab in Singapore was the first of its kind in Asia Pacific.

Specifically, implementation of the AEC by December 2015 will liberalise and facilitate trade in goods and services, as well as allow for a smoother flow of labour and capital across borders. The lifting of trade barriers will also reduce the costs of production and attract manufacturing foreign direct investment (FDI).

An integrated AEC is also forecast to add an extra 14 million new jobs and boost the region's annual growth to 7.1 percent by 2025, according to a joint study by the UN's International Labor Organization and the Asian Development Bank.

The bottom line is that a single Southeast Asian market will become an even more formidable economic competitor than it already is today. This comes as at a time when China's wage cost advantage is eroding. Partly as a result of labour cost advantage, returns on FDI for multinational companies operating in ASEAN have been superior to those in China, especially for U.S. manufacturing firms.

Indeed, Chinese companies are themselves investing more in Southeast Asia. According to Citi research, while the country's outward direct investment (ODI) remains small in absolute terms, ASEAN's share of China's ODI has more than doubled from 1.9 percent to 5.1 percent since 2002.

So what progress has ASEAN made towards its goal of creating an integrated economic bloc by end 2015? Quite a lot it seems. According to a scorecard mechanism to track the implementation of measures in the AEC blueprint, over 80 percent of the measures have been implemented to date.[iii]

Capitalising on opportunities in ASEAN

Despite the optimism, there are multiple challenges to making the AEC a reality.

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Integrating the capital markets of the 10-nation bloc, for one, means having to adjust domestic currencies, capital accounts and taxation policies, as well as different levels of capital market maturity.

Policy makers in some member countries will also be hard pressed to eliminate obstacles to investment. This is reflected in the World Bank's 2013 Ease of Doing Business Index that ranked the Philippines 138th and Indonesia 128th out of 185 countries.[iv] However, we do see that there are efforts to close the gap. In the Philippines for example, the Senate recently approved a bill to expand the participation of foreign banks in its financial sector. This is expected to pave the way for greater foreign participation in the banking industry in the Philippines, boost trade and create more jobs.

There are also concerns that integration could worsen income equality across the region if the process is not well managed. Meanwhile, ongoing territorial disputes in the South China Sea could adversely impact efforts towards regional cooperation.

That said, even if the AEC does not achieve all its goals by the 2015 deadline, the synergies generated over time by efforts to integrate across borders are likely to generate new opportunities for regional businesses. More importantly, the proliferation of cross-border networks has already driven tighter ASEAN economic integration since the 1980s.

Simply put, the process of working towards a single market, even if it is not fully realised, is already generating benefits for businesses in Southeast Asia. The AEC is a potential game changer that can transform the economic and commercial landscapes of member nations, opening up vast opportunities for businesses. Leading companies are already positioning themselves to leverage the potential of this dynamic region and tap the opportunities presented by the AEC; while companies that adopt a 'wait and see' approach risk losing a first mover advantage in this huge market.

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