



# Global Economy Watch

## Economic integration: the key to unlocking ASEAN's export potential?



Dear readers,

When discussing the state of the global economy, a key theme has been the slow-down in world trade growth in recent years. However, one part of the world is defying this trend—South East Asia.

In November, South East Asia will be at the front of the global economic stage, when both the Asia-Pacific Economic Cooperation (APEC) and the Association of South East Asian Nations (ASEAN) meet. Since its formation in 1967, ASEAN has facilitated several free trade agreements which have seen the region's nations become increasingly integrated, as they work towards the free movement of goods and skilled labour.

In this edition, we have looked in more detail at the ASEAN nations, and how further economic integration could expand their intra-regional export market. Our analysis shows that:

- The region is well suited to export expansion, given its strong and consistent output growth and its vast working age population. Supporting this, our upcoming APEC survey to be released in November shows over 88% of ASEAN respondents were confident of revenue growth over the next 12 months.
- ASEAN intra-regional export volumes are on course to grow from \$330 billion currently to \$375 by 2025 (1.5% p/annum growth rate). If, for illustrative purposes, the implementation of

'Blueprint 2025' led to a 1pp increase in the growth rate, intra-ASEAN exports could reach \$410 billion. Achieving growth of near this order is dependent upon further trade liberalisation.

We don't expect this expansion to be uniform—as some of the less developed economies within the ASEAN bloc and those that are more specialised in services exports are better placed to grow their export share. To maximise their own trade volumes, ASEAN exporters could target these higher growth potential markets.

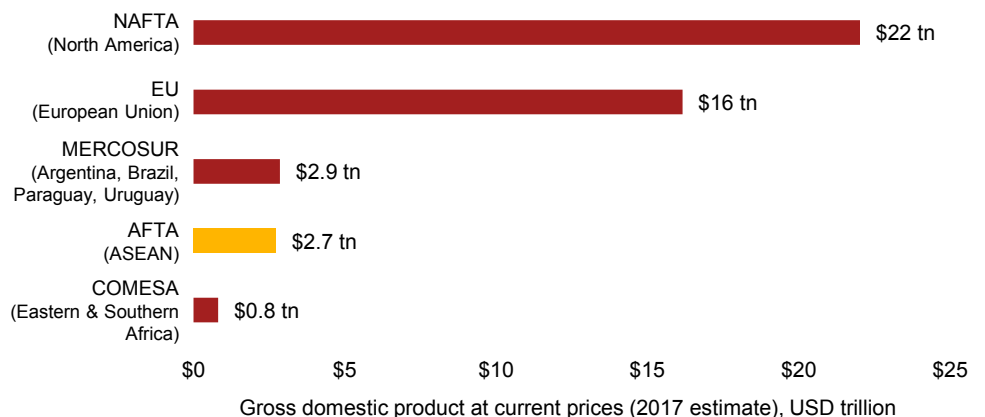
In our economic update, we present the results of our 'nowcasting' model for the US economy which was constructed using the same approach as for the UK GDP nowcasting model set out in our July UK Economic Outlook. For the US, we project GDP to expand by 2.2% this year, faster than the 1.5% growth registered last year but still relatively modest by pre-crisis standards.

Finally this month we have looked at the economics of natural disasters, which tragically have been all too frequent recently. Our analysis shows that such disasters do appear to be occurring more often on average since the late 1990s than in earlier decades, although their impact can sometimes be mitigated to a degree now by preventative measures such as better early warning systems.



Kind regards  
**Barret Kupelian**  
PwC | Senior Economist

**Fig 1: ASEAN is the world's fourth largest trading bloc in terms of GDP, with a value of \$2.7 trillion. ASEAN is behind only NAFTA, the EU, and MERCOSUR.**



Sources: PwC analysis, IMF



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# Economic update: US data points to gradual Fed tightening

## Reasonable outlook for the US for remainder of year

Building on the UK GDP nowcasting model published in our July UK Economic Outlook, we have built a US GDP nowcasting model. This follows the same basic machine learning principles as the UK model and, as before, we have tested the historic accuracy of the US model, which has performed well in predicting actual GDP growth for the past five years based on data available at the time (see Figure 2).

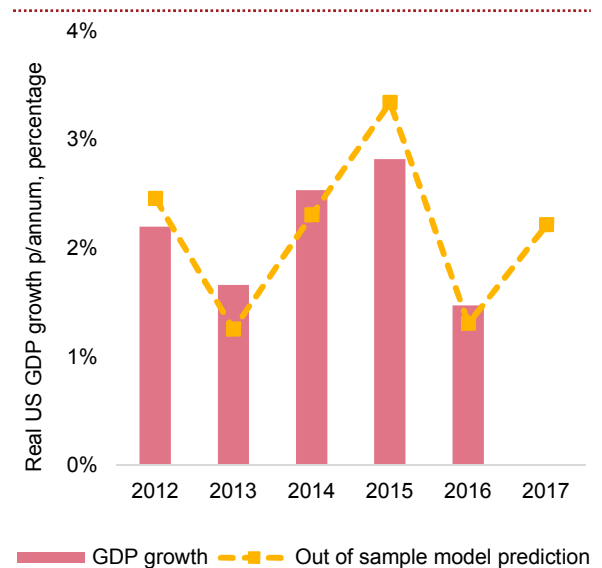
Our nowcasting model suggests that the US economy is on track to grow by 2.2% this year, slightly below the median GDP growth forecast of the Federal Reserve. This implies average quarter-on-quarter growth of about 0.5% (2% annualised) in the second half of 2017, although this could be temporarily affected by the recent hurricanes. Survey data also confirms the buoyant nature of the US labour market, with a recent National Federation of Small Business (NFSB) survey reporting that finding qualified labour is now the single most important business problem in the US.

## Fed prepares to raise rates again ... but fiscal policy remains uncertain

However, what businesses are currently monitoring is the policymaking environment in the US. September saw the Federal Reserve outline its plans in detail on the form of future monetary tightening, including the planned reduction of its balance sheet. As regards interest rates, the Fed's updated median projections indicate another rate hike by the end of the year (but this should be of less concern to business as it is well signposted).

The key area of focus in the next few months will be on fiscal policy. More specifically, what form the proposed corporate tax cuts will take, if indeed they can be passed through Congress.

Fig 2: In 2017 we project real GDP growth of 2.2%



Sources: PwC analysis

# Natural disasters are occurring more often, but how much do they cost?

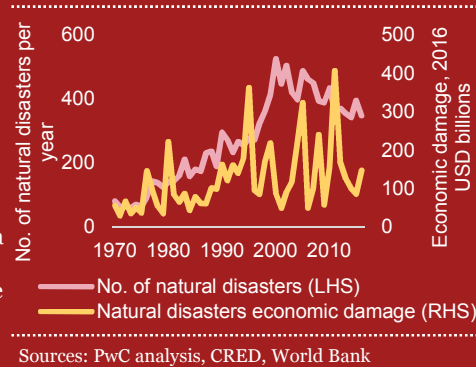
Unfortunately, natural disasters are back in the spotlight and these events are above all human tragedies. However, they also tend to disrupt households, businesses and governments, and some can have macroeconomic effects.

The latest data from the *Centre for Research on the Epidemiology of Disasters* (CRED) estimates there were 348 natural disasters<sup>1</sup> in 2016 that cost approximately \$150 billion<sup>2</sup> in total. This sum is a very partial measure of cost, as it does not quantify loss of life or revenue as a result of natural disasters. Subject to these limitations, we deflated this data to get a picture of real costs over time (Figure 3). We should be cautious about putting too much weight on precise conclusions from this, due to the volatility of costs and the unique nature of natural disasters. However there has been a gradual upward trend in both the number and total real cost of natural disasters since the 1970s – what are the key factors behind these trends?

## The megatrends of climate change, urbanisation and technology play a role...

NASA estimates 16 out of the 17 warmest years in the last 136 years have all occurred since 2001<sup>3</sup>. A warmer atmosphere will have a higher average moisture content, creating the potential for more extreme precipitation events. The Paris Climate Agreement seeks to co-ordinate government commitments and action to limit global warming to below two degrees. PwC analysis in the Low Carbon Economy Index shows while record progress has been made, it still falls short of the rapid reductions needed to

Fig 3: The real cost of damages from natural disasters is increasing



Sources: PwC analysis, CRED, World Bank

achieve the two degree goal.

Second, urbanisation and rapid population growth have pushed around one quarter of the world's population to live in areas classified as high risk from natural disasters<sup>4</sup>. This problem is particularly acute in less developed economies, where the reward of higher salaries in high-risk urban areas is often judged to outweigh the risk of living in a high-risk area.

Finally, some of this increase may be "artificial", as enhanced communication networks and technological advances have enabled scientists to notice natural disasters more frequently than in the past.

## ...but preventative measures have helped to mitigate some of the costs of disasters

Taken at face value, Figure 3 implies the cost of physical damage per natural disaster has fallen by around a third in real terms since 1970.

Again, we should be cautious about putting too much weight on precise estimates, however a plausible explanation for this apparent trend is that enhanced preventative measures have helped to limit costs. These range from early warning systems, which detect weather patterns that lead to hurricanes and tornadoes at a more localised level, to planning laws that encourage maintaining wetlands in flood prone areas to absorb excess water.

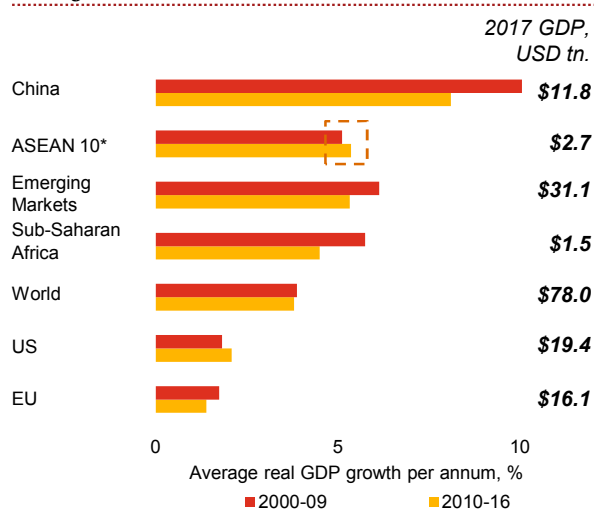
On a regional level, the destruction of tangible assets leads to a deterioration in productive capacity, while consumer spending on non-essential items generally falls in the immediate aftermath of a disaster. However at a macro level, academic evidence is mixed as to the net impact on GDP growth. For example, rebuilding efforts can offset the loss of assets and an influx of aid can help restore production, so leading any initial drop in GDP due to the disaster to be reversed relatively quickly.

However, while output as measured by GDP may not be significantly impacted beyond the short term, natural disasters cause devastation for those affected and may be becoming more prevalent for the reasons discussed above. Significant investment in increasing the risk-resilience of infrastructure and our ability to manage the impacts of extreme events is therefore also becoming an increasing priority for governments and business.

1 For a disaster to be recorded, one of the following criteria must be met: 10 people reported killed, 100 people report affected, declaration of a state of emergency or a call for international assistance is made. 2 Cost of damage was deflated using World Bank data, and is measured in 2016 USD throughout (i.e. excluding the impact of general price inflation). 3 NASA Global Climate Change Facts, 2016. 4 World Bank, Natural Disaster Hotspots, 2005.

# Economic integration: the key to unlocking ASEAN's export potential?

**Fig 4: ASEAN economic growth has proven consistently strong**



\*GDP weighted growth

Sources: PwC analysis, IMF

This year marks the 50th anniversary of the establishment of ASEAN. Since its formation it has expanded to ten countries (as listed in Figure 6) and total ASEAN GDP has expanded from 1% to 3.4% of global output<sup>1</sup>. If it were a single country, ASEAN would be the world's seventh largest economy, with a GDP of around \$2.7 trillion<sup>2</sup>, and the third most populous area of the world with around 635 million people, of which over 430 million are of working age.

In 2015, the ASEAN Economic Community (AEC) formally launched and adopted *Blueprint 2025*. This outlines their strategy to achieve a 'deeply integrated and highly cohesive' economy, a single market allowing the free movement of goods and people. And there has been already been great progress on this – in 2016, for example, 96% of tariff lines on intra-regional trade were zero. This November, the Philippines will host the 31<sup>st</sup> ASEAN summit where furthering regional integration is top of the agenda. So how well equipped is ASEAN to further integrate its economies?

## Strong and stable growth in the ASEAN economies should benefit regional trade

A key challenge for any business is planning ahead. Prospective exporters face the additional challenge of planning for business cycle fluctuations in foreign markets, which can disrupt revenue flows. The average ASEAN GDP-weighted growth rate since 2000 has been 5.2% per annum - this is notable not just because it is faster than the global average of 3.8% per annum<sup>3</sup>, but also because of its stability.

Specifically, when we compare the standard deviations of GDP growth across high-growth regions since 2000, ASEAN compares favourably. Sub-Saharan Africa came narrowly second, while the Emerging Markets, China and the Middle East & North Africa were all more turbulent. For example, Figure 4 shows how little difference there was in average ASEAN output growth between 2000-09 and 2010-16 – it's worth noting this was a period encompassing the Global, but not the Asian, Financial Crisis.

Given its stable footing, how large could intra-regional ASEAN trade grow by 2025?

## Intra-ASEAN trade could reach between \$375 and \$410 billion by 2025

Exports in the ASEAN economies are growing, but not as fast as GDP – the compound annual growth rates since 2010 were 2.9% and 4.9% respectively. In 2016, total exports from ASEAN countries accounted for 7% of global exports, or \$1.1 trillion. This total contribution was behind only the EU (24%), US (13%) and China (9%)<sup>4</sup>. However intra-regional trade is a markedly smaller market than this - in 2016, intra-ASEAN exports were valued at only just over \$330 billion. For context, the EU's single market saw \$3.4 trillion of exports within its borders.

Assuming the current rate of post-crisis growth continues, we project intra-ASEAN exports could surpass \$375 billion by 2025. However, various academic studies show that single market access has a positive effect on intra-trade volumes, in some cases by up to 115% in the long run<sup>5</sup>. Therefore if, for purely illustrative purposes, we assume an acceleration to the tune of 1 percentage point per year due to the implementation of *Blueprint 2025* – intra-ASEAN export volumes could reach \$410 billion, as shown in Figure 5.

These overall estimates for ASEAN disguise significant heterogeneity across sectors and countries. For example, the data shows that intra-regional services exports have been growing almost 4 pp per year faster than goods exports since the financial crisis. Likewise, the relatively less developed economies of Myanmar and Vietnam have seen double digit intra-regional export growth, while Singapore and Malaysia have experienced slower growth per annum.

## Diversification is needed for evenly distributed benefits across ASEAN

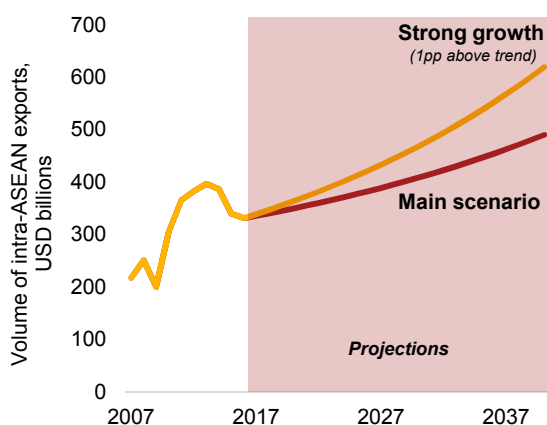
This heterogeneity becomes even more apparent when we breakdown individual ASEAN nation's total exports. As a whole, ASEAN is a net exporter and the majority of exports are goods - but which nations are most likely to benefit from the high export growth potential in services sectors? Cambodia and the Philippines were the only nations where services comprised over 30% of total exports (see Figure 6). Travel and business services provided the majority of service exports for Cambodia and the Philippines respectively.

When we look at the change in services exports since 2010, we can see which countries have made the most progress towards diversifying away from goods exports. Myanmar (25%) and Thailand (23%) made the largest moves (from 4% and 15% respectively). ASEAN as a whole has increased its share of services exports by 5 percentage points to 22% - and continuing to focus on service exports should keep it well positioned in the global economy for years to come.

The ASEAN region is culturally, linguistically and politically diverse. Therefore any integration needs to be highly customised, while common interests need to be identified and exploited. Although integration is still relatively limited in comparison to the EU, things are moving forward. If ASEAN policymakers can implement *Blueprint 2025*, the removal of barriers to further integration could see ASEAN become an even more significant global market.

1 World Bank, market exchange rates. 2 2017 estimate, current prices. 3 At market exchange rates. 4 IMF Direction of Trade Statistics, Value of Good exports, 2017. 5 "EU membership boosts intra-EU trade by 115% relative to a position of WTO membership" HM Treasury, 2016.

**Fig 5: ASEAN is on course to surpass \$375 billion of intra-regional trade by 2025**



Sources: PwC analysis, ASEANstats

**Fig 6: Mineral & Chemical products, and Metals, Machinery & Transport dominate ASEAN exports**

	Composition of total exports in 2016, %						Goods
	1	2	3	4	5	6	
Brunei	0.2	84	5	1	3	7	1 Animal & Foodstuffs
Cambodia	3	50	13	3	22	9	2 Mineral & Chemical Products
Indonesia	18	42	24	2	7	7	3 Metals, Machinery and Transport
Lao PDR	24	30	24	1	18	3	4 Other
Malaysia	9	26	44	5	8	8	5 Travel
Myanmar	29	34	11	1	14	10	6 Other
Philippines	6	12	43	4	6	30	
Singapore	2	37	32	6	3	21	
Thailand	11	19	44	3	17	6	
Vietnam	12	25	49	7	4	2	
ASEAN 10	9	24	40	5	8	14	

Red < 10% Orange 10%-25%, Green 25%+

Sources: PwC analysis, ASEANstats



# Projections: October 2017

	Share of 2016 world GDP		Real GDP growth			Inflation		
	PPP	MER	2017p	2018p	2019-2023p	2017p	2018p	2019-2023p
Global (Market Exchange Rates)		100.0%	3.0	2.9	3.0	2.5	2.4	2.5
Global (PPP rates)	100.0%		3.6	3.5	3.6	2.4	2.7	2.7
G7	31.0%	47.1%	1.9	1.8	1.9	1.8	1.8	1.8
E7	36.9%	25.8%	5.3	5.2	5.1	3.2	3.3	3.6
United States	15.5%	24.7%	2.2	2.2	2.3	2.2	2.1	2.0
China	17.8%	14.9%	6.6	6.2	5.7	2.0	2.2	2.8
Japan	4.4%	6.6%	1.2	0.7	0.8	0.5	0.9	1.5
United Kingdom	2.3%	3.5%	1.5	1.4	2.0	2.7	2.7	2.2
<b>Eurozone</b>	<b>10.4%</b>	<b>13.9%</b>	<b>2.0</b>	<b>1.7</b>	<b>1.5</b>	<b>1.4</b>	<b>1.4</b>	<b>1.4</b>
France	2.3%	3.3%	1.6	1.6	1.6	1.0	1.2	1.2
Germany	3.3%	4.6%	1.9	1.7	1.4	1.8	1.7	1.7
Greece	0.2%	0.3%	0.7	1.7	1.8	1.1	1.1	1.1
Ireland	0.3%	0.4%	4.3	3.4	2.6	0.4	0.9	1.5
Italy	1.9%	2.5%	1.2	1.1	1.2	1.2	1.2	1.4
Netherlands	0.7%	1.0%	2.8	2.1	1.8	1.4	1.5	1.3
Portugal	0.2%	0.3%	2.6	1.8	1.1	1.6	1.5	1.4
Spain	1.4%	1.6%	3.1	2.3	2.0	1.8	1.2	1.2
Poland	0.9%	0.6%	3.4	3.3	3.5	1.8	2.0	2.4
Russia	3.2%	1.7%	1.3	1.4	1.5	4.2	4.0	4.0
Turkey	1.7%	1.1%	4.1	3.2	3.4	10.0	8.1	7.0
Australia	1.0%	1.7%	2.7	2.8	2.7	1.9	2.3	2.5
India	7.2%	3.0%	6.9	7.4	7.7	3.6	5.0	5.0
Indonesia	2.5%	1.2%	5.1	5.3	5.4	4.2	4.6	5.1
South Korea	1.6%	1.9%	2.9	3.0	3.0	2.2	2.5	2.7
Argentina	0.7%	0.7%	2.6	2.8	3.0	25.0	-	-
Brazil	2.6%	2.4%	0.5	1.7	2.6	4.0	4.5	4.5
Canada	1.4%	2.0%	2.4	1.9	2.2	1.9	1.8	2.0
Mexico	1.9%	1.4%	1.8	1.9	3.0	5.4	3.5	3.0
South Africa	0.6%	0.4%	0.8	1.2	3.0	6.1	5.8	5.5
Nigeria	0.9%	0.5%	0.7	1.8	4.2	15.0	14.1	12.0
Saudi Arabia	1.5%	0.8%	0.8	1.5	3.5	3.5	4.8	2.5

**Sources:** PwC analysis, National statistical authorities, Datastream and IMF. All inflation indicators relate to the Consumer Price Index (CPI). Argentina has recently launched a new CPI measure, which only contains data from April 2016. Therefore we only project inflation for 2017, and will provide 2018 and 2019-2023 projections once a longer series is available. Note that the tables above form our main scenario projections and are therefore subject to considerable uncertainties. We recommend that our clients look at a range of alternative scenarios.

## Interest rate outlook of major economies

	Current rate (Last change)	Expectation	Next meeting
Federal Reserve	1.25% (June 2017)	Further gradual tightening in the next two quarters	31 October – 1 November
European Central Bank	0.00% (March 2016)	No rate rise for the foreseeable future	26 October
Bank of England	0.25% (August 2016)	Rates could increase within next few months	2 November



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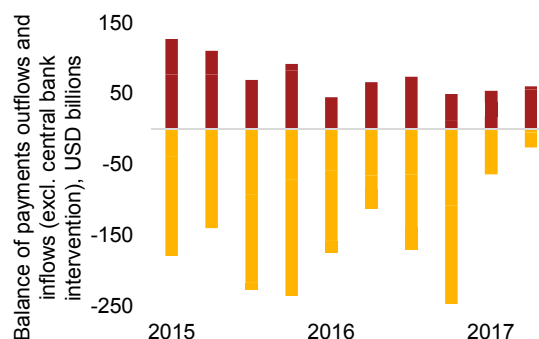
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## Chart of the month

Beijing's currency support and crackdown on outflow channels seems to be working. Net capital inflows to the country turned positive in the first half of this year.

Compared to a \$420 billion deficit in 2016, China ran a \$16 billion surplus in H1 2017.

## Net capital inflows to China turned positive in H1 2017



Source: FT, CEIC

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