

SOUTHEAST ASIAN ECONOMIC OUTLOOK 2010



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FOREWORD

Foreword

The global financial crisis was a litmus test for Southeast Asia's economic dynamism. The region has emerged strongly from the test, in large part as a result of the considerable improvements in the macroeconomic and financial policies carried out over the past decade. While this is encouraging, many challenges remain, in particular achieving more balanced growth in the future.

Rebalancing growth is not just a matter of shifting from exports to domestic demand and making the region's growth pattern less dependent on import demand by OECD economies. It involves reducing the region's excessive export dependence on a narrow range of manufactured products, such as electronic parts and components, and moving up the technological ladder in the global value chain.

This rebalancing will require reallocating public resources to meet the growing need for economic and social infrastructure, which is essential to allow the region to exploit untapped growth opportunities. This includes speeding up the regional integration process and expanding transport networks within and across countries. Rebalancing does not mean reverting the economic openness and integration into the global economy achieved so far. It implies making greater use of trade and investment opportunities arising from deeper economic integration in Asia and the Pacific.

This first edition of the *Southeast Asian Economic Outlook* suggests that the rebalancing process is already underway. Real GDP growth in six Southeast Asian countries (Indonesia, Malaysia, the Philippines, Singapore, Thailand and Viet Nam) is projected to reach 6.0% per year on average in 2011-15, which is similar to the pre-crisis level. This time, however, the region's economic growth is likely to rely more on domestic consumption and investment.

Southeast Asia is a region of strategic importance to the OECD. In May 2007, the OECD Ministerial Council adopted a resolution to strengthen the Organisation's relations with the region under its Enhanced Engagement Strategy. In order to contribute to this initiative, in April 2009, the OECD Development Centre launched its new economic outlook project for the region. This *Outlook* is not just a report. It is a tool to facilitate informed dialogue between OECD and Southeast Asian countries. I hope it will also help the dialogue among Southeast Asian countries themselves around those policy areas that are critical for the region's development.

Angel Gurría
OECD Secretary-General
November 2010

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PREFACE

Preface

The *Southeast Asian Economic Outlook* (SAEO) is the latest of three regional economic outlooks published by the OECD Development Centre. The others are the *African Economic Outlook* and the *Latin American Economic Outlook*. This new Outlook focuses on Indonesia, Malaysia, the Philippines, Singapore, Thailand and Viet Nam. It also addresses relevant economic issues in China and India in order to fully reflect economic developments in the region.

Overall Southeast Asia has demonstrated a V-shape recovery from the global financial crisis. This remarkable resilience underscores a considerable improvement in the region's macroeconomic and financial policies over the past decade. Many Southeast Asian economies have also benefited from both the large fiscal and monetary stimulus packages implemented in the early stages of the economic downturn and China's early rebound. Yet, we may wonder how these economies will look in the next five years. Are they likely to go back to export-led growth patterns as observed before the crisis or adopt different growth and development paths?

“Rebalancing growth” seems to be the catch phrase in the region. In a final communiqué by the 16th ASEAN Summit in Hanoi in April 2010, regional leaders recognised the need to support more balanced growth within and across economies. This is indeed the main theme running throughout the inaugural edition of the SAEO. Despite the importance of this topic for the future of Southeast Asian economies, there is so far little information on whether there has been any real progress in this direction and in what form rebalancing will take place over the medium term. The SAEO 2010 starts addressing this gap by providing comparable quantitative information on rebalancing of growth patterns in the region.

Achieving a more balanced growth requires new policies and credible medium-term fiscal frameworks under national development plans and strategies. The development of transport infrastructure, for example, has been emphasised as an important area where new financing methods are badly needed. Further efforts should be made to improve both “hard” and “soft” infrastructures in the region, as they are central to promoting regional integration and connectivity while reducing poverty and inequality.

The Development Centre is a bridge between OECD member countries and developing and emerging economies. We enjoy the full membership of three Southeast Asian countries, namely Indonesia, Thailand and Viet Nam and have benefited from the generous support of other countries in the Asia-Pacific region (*i.e.* Malaysia, the Philippines and Singapore) to carry out this work. Both government officials and

academic experts from these countries have provided us with substantive inputs and important policy insights.

I hope that this new publication by the Development Centre will promote informed policy dialogue between Southeast Asian and OECD countries and serve as a tool to foster a better understanding of the development prospects of this dynamic region home to almost 10% of the world population.

Paris, 9 November 2010

Mario Pezzini

Director, OECD Development Centre

EXECUTIVE SUMMARY

Executive Summary

Southeast Asia has emerged strongly from the global financial crisis. The average economic growth rate of six countries¹ in the region (Indonesia, Malaysia, the Philippines, Singapore, Thailand and Viet Nam) is projected to reach 7.3% in 2010, compared to 1.3% in 2009. What stimulus measures have these governments adopted to counteract the economic downturn? How should exit strategies be formulated and implemented without jeopardising the current recovery? Looking beyond near-term developments, policy makers in the region have expressed their strong desire to rebalance growth towards domestic demand and to become more resilient to external shocks. What steps should then be taken to stir their economies in this direction while reducing poverty and inequality? In what way can regional integration contribute to making Southeast Asian economies more balanced and inclusive?

The inaugural edition of the *Southeast Asian Economic Outlook* (SAEO) addresses these questions. It also includes an in-depth analysis of transport infrastructure development and its implications for regional integration.

Southeast Asia's near-term growth outlook is bright, but downside risks remain

Emerging strongly from the crisis, export-dependent Southeast Asian countries (Malaysia, Singapore and Thailand) have benefited considerably from China's early rebound through their close trade linkages. Indonesia, the Philippines and Viet Nam, with relatively large domestic markets, have also proven resilient to the crisis, as they were able to provide effective fiscal and monetary stimulus packages in the early stages of the economic downturn.

The current cycle has underscored a considerable improvement in the region's macroeconomic and financial policies over the past decade. Both leading and coincident indicators point towards steady growth in the region based on the initial strong growth of exports and sound domestic consumption and private investment, supported by improved business sentiment.²

While budget deficits and public debt levels, if not carefully managed, could raise concerns in some of these countries, the greater risk could come from outside the region through weaker-than-expected import demands in OECD countries. Another element to consider is related to China. The People's Bank of China is tightening monetary policy to restrain very rapid growth in domestic credit and to

contain excessive increases in asset prices. This is likely to slow down Chinese real economic growth for several months. Those economies with the strongest trade links to China could face headwinds from such a slowdown.

Shifting macroeconomic policies towards more normal stances is necessary but requires caution

The fiscal stimulus measures put in place after the global economic downturn were of unprecedented scale for the region³ and contributed significantly to the rebound of real GDP growth in 2009 and 2010. With recoveries now well underway, the region's macroeconomic policies will need to shift towards less expansionary fiscal and monetary policy stances, restrain inflation and maintain sound fiscal and external finances, while allowing for temporary changes during the process to respond to further external shocks should they arise. Greater flexibility of exchange rates combined with more effective management of capital flows will be needed to support the exit measures. Enhancing regional macroeconomic co-operation, in particular strengthening regional monitoring and surveillance, is also important to manage potential risks in the region.⁴

The region's medium-term growth and development outlook is favourable⁵

Real GDP growth in six Southeast Asian countries is projected to achieve 6.0% per year on average in 2011-15, which is more or less the same as the pre-crisis level (see Table 1). The region's steady growth will be led by the above-average growth rates in Indonesia and Viet Nam, supported by strong domestic demand. The results of the medium-term economic projections highlight three main features of rebalancing growth in the region.

Table 1. Real GDP Growth
(annual percentage changes)

	2010	2015	Average 2003-07	Average 2011-15
Indonesia	6.1	7.1	5.5	6.6
Malaysia	6.5	5.3	6.0	5.5
Philippines	6.0	4.4	5.7	4.6
Singapore	14.0	4.5	7.5	4.7
Thailand	7.0	5.1	5.6	5.2
Viet Nam	6.8	7.2	8.1	7.1
Average of the six countries	7.3	6.0	6.1	6.0

Source: OECD Development Centre, MPF-SAE0 2010.

First, the process of rebalancing growth in Southeast Asia is likely to be gradual over the next five years. Both private consumption and investment will become the new engines of growth in the region, though exports will remain important. The current account surplus relative to GDP is expected to shrink gradually as the growth of imports outpaces that of exports. This is also mirrored in the saving-investment balance as the region's gross domestic investment ratio is projected to increase steadily by 2015.

Second, the pattern of rebalancing growth will differ considerably across countries. For example, the current account surplus in the Philippines and Thailand is projected to move back to the pre-crisis level, while in Malaysia and Singapore it is expected to decline to 12-16% of GDP. In Indonesia, the current account balance is likely to turn from a surplus of 1.9% in 2003-07 to a deficit of -0.8% in 2011-15. In Viet Nam, the current account balance will remain in deficit throughout 2011-15, though its relative size is projected to shrink from the 2010 level.

Third, the fiscal balances of the region's four ASEAN countries (Indonesia, Malaysia, the Philippines and Thailand) are projected to remain in the range of -1.2% to -2.4% of GDP in 2011-15. In Viet Nam, it would be difficult to cut government spending as many infrastructure projects are already in the pipeline. Therefore, the country's fiscal deficit is likely to increase to -4.6% in 2011-15. Singapore is an exceptional case in which the revenue streams from sovereign wealth funds provide fiscal space for the government to finance infrastructure projects. In short, it is important that Southeast Asian countries keep their fiscal policy frameworks in line with the medium-term policy goals set by their national development plans.

Improved fiscal policy frameworks are required to implement national development plans

The key question for policy makers in Southeast Asia today is how to shift to a more balanced growth model over the medium term. To be sure, most countries in the region have already taken several measures necessary to rebalance growth under their new five-year development plans. A significant number of infrastructure development projects and those aimed at poverty reduction and social protection have been planned for the coming years. However, concerns have been raised about the financing of such projects, given the reduced fiscal space governments will face in the post-crisis period. Setting a credible medium-term fiscal framework is therefore critical for the feasibility of a country's five-year development plan, because such a framework will lead to greater fiscal discipline and thereby allow for more efficient use of scarce public resources.

To improve their fiscal policy frameworks, ASEAN countries need to create well-designed fiscal rules. Independent fiscal institutions can oversee such fiscal rules. Medium-term budgetary frameworks consistent with national development plans are also required to ensure that planned targets can be met.

Regional integration in Southeast Asia is being shaped by ASEAN's two-pronged strategy

ASEAN countries are engaged in a two-pronged strategy for regional integration: promoting the progressive transformation of ASEAN from a free trade area (AFTA) today to a single market and production base envisioned as an ASEAN Economic Community (AEC) by 2015; and enhancing ASEAN's competitiveness through bilateral and plurilateral trade agreements with major partner countries in Asia and beyond. Meanwhile, ASEAN countries' links with global production networks have been strengthened and substantially transformed by China's emergence as a regional production centre.

Rebalancing growth does not mean turning back from the economic openness and integration into the global economy that have generated enormous gains for the region. ASEAN countries should implement domestic policy reforms that are necessary to reap the full benefits of creating a single regional market for their 600 million people. In particular, they should consider mechanisms to address the different and divergent levels of productivity within the region.

Promoting regional integration helps to rebalance growth

ASEAN countries should take a fresh look at their economic ties with China. ASEAN-China economic relations are likely to become even stronger and deeper owing to the latter's continued high growth and implementation of the *ASEAN-China Comprehensive Economic Co-operation Agreement* that came into force in early 2010. A major challenge for ASEAN countries is to reduce their excessive export dependence on a narrow range of electronic products (mostly parts and components) and to move up the technological ladder in the value chain. ASEAN countries should also develop more niche and speciality products within the nine Priority Goods Sectors (PGS).⁶ These priority sectors are politically and economically important for AEC implementation – politically because they have been chosen to serve as front-runners for deeper economic integration, and economically because the nine PGS taken together account for more than half of the total ASEAN merchandise exports. The idea of rebalancing growth, therefore, is not just to move away from exports to domestic demand but also involves reallocating public resources to support new growth areas (for example, diversification into healthcare product markets).

Transport infrastructure development is central to promoting ASEAN integration and reducing development gaps among and within its member states

Efforts need to be made at both national and sub-national levels in order to reap the full benefits of the regional integration process. Transport infrastructure development involves not only investment in physical facilities but also improvements in "soft" infrastructure comprising transport policies, regulations and procedures, and

multilateral initiatives and agreements. Transport infrastructure is most developed in Singapore followed by the region's middle-income countries, and it is significantly less developed in Cambodia, Laos and Myanmar.

The region's distinctive geographical features and rapid economic growth have created a number of challenges that are shared to varying degrees by its members. These include excessively high transport costs, urban congestion, and inadequate competition and efficiency in air transport. A case in point is the weak transport infrastructure in Indonesia. This has hindered Indonesia's integration into regional production chains and its internal economic integration and development. The problems in transport can be attributed to a combination of inadequate roads, ports and other physical infrastructure, together with weak regulatory policies, customs procedures and planning. Indonesia's authorities have recently taken a number of important steps to promote more effective infrastructure development, including measures to encourage private-sector investment, improve customs procedures and combat corruption. It is therefore important to monitor the implementation and impact of these measures.

New financing methods can promote private infrastructure investment in Southeast Asia

Southeast Asian countries need to finance a huge amount of infrastructure investments, such as highways, railways, ports and air transport systems.⁷ Tax revenues provide a stable source of funding for infrastructure investment. There are, however, increasing concerns over their future, as the fiscal capacity of many Southeast Asian economies will be constrained in the post-crisis period. Individual governments do not have sufficient funds to meet the potential demand for infrastructure investment. New financing methods that are already successful in some OECD countries, such as infrastructure revenue bonds, could also be applied to the transport sector in Southeast Asian countries. This financing method is appropriate to support construction and maintenance of transport infrastructure in the form of Public-Private Partnerships (PPPs), as the construction and operation of transport services can generate fee revenues from daily operations. However, soft infrastructure, such as policies, regulations and procedures, and multilateral initiatives and agreements must complement the PPP approach.

Conclusions and policy recommendations

The global financial crisis has offered an important opportunity for Southeast Asian countries to rethink past growth strategies and project new development visions. The analyses and discussions presented in this *Outlook* highlight the need to implement five-year development plans with a view to rebalancing growth and instituting a credible fiscal policy framework which is conducive to greater fiscal discipline. In particular, well-designed fiscal rules, independent fiscal agencies and a medium-term budgetary framework are crucial institutional ingredients to ensure fiscal discipline. While such institutions are becoming increasingly important across OECD countries, there is room for improving such institutional settings in Southeast Asia.

Another conclusion emerging from the SAEO 2010 is that the future development of Southeast Asian countries is likely to be uneven across sectors and economies, unless necessary measures are taken. Areas of policy action are to identify and support national and local comparative advantages. In the Roadmap for an ASEAN Economic Community, policy makers in these countries have taken a number of sector-specific measures (e.g. through investment in R&D and capacity building) necessary to enhance the external competitiveness of their priority sectors. Further work will be required to monitor the progress of existing sector-specific measures and to identify new measures, where necessary, through regular consultations with national and local stakeholders, including ASEAN dialogue partners.

The development of a more integrated transport infrastructure constitutes another area of policy action necessary to foster regional and sub-regional connectivity. During the last two decades there has been significant progress in developing road, rail, maritime and air transport networks within and across countries. The expansion of transport networks has spurred both internal and regional trade growth. More areas and people have benefited from greater access to economic opportunities thanks to improved transport infrastructure and logistics services. In this way, regional integration can help to promote more balanced growth in the region. However, given the huge investment needs for infrastructure development, new financing methods, such as infrastructure revenue bonds, should be further explored to promote effective PPPs in the region.

Finally, the effectiveness of regional co-operation hinges largely upon the form of co-operation. While co-operation may take different forms, OECD's peer review mechanism presents a flexible instrument which may be suitable for policy dialogue and capacity building in Southeast Asia. Regional monitoring and surveillance based on peer reviews could potentially work well in the region, including the support of macroeconomic policy co-operation.

NOTES

1. In 2009 these six countries constituted 95% of the total GDP (in USD using purchasing-power-parity exchange rates) and 86% of the total population of ASEAN countries. The Association of Southeast Asian Nations, or ASEAN, consists of ten member countries, namely Brunei Darussalam, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand and Viet Nam.
2. Leading indicators in the third quarter of 2010, however, suggest some signs of growth moderation in Southeast Asian economies. This is due largely to slower inventory accumulation and a reduced contribution from net exports. The OECD Development Centre's Asian Business Cycle Indicators (ABCIs) are available at www.oecd.org/dev/asiapacific/abcis.
3. The aggregate of the stimulus packages adopted by the six ASEAN countries amounted to an average of 4% of their combined 2009 GDP. This number would be much larger should two additional stimulus packages in Thailand and Viet Nam be included here.
4. See Tanaka (2009), "Regional Integration in Southeast Asia: Better Macroeconomic Co-operation Can Mitigate Risks", *Policy Insights* No. 90, OECD Development Centre, February.
5. The OECD Development Centre has developed the Medium-Term Projection Framework for Growth and Development (MPF-SAEO 2010). The MPF-SAEO 2010 provides individual five-year growth and development outlook (2011-15) for six countries (Indonesia, Malaysia, the Philippines, Singapore, Thailand and Viet Nam) to feed the discussion on major policy challenges for rebalancing growth in the region. The coverage of the MPF will be extended to other ASEAN countries in the future issues of the SAEO.
6. The nine PGS are agro-based products, automotives, ICT equipment, electronics, fisheries, healthcare products, rubber-based products, textiles and apparel, and wood-based products.
7. According to a recent Asian Development Bank Institute's study, total investment needs for national infrastructure development in ASEAN countries (excluding Brunei Darussalam and Singapore) are estimated to be in the order of USD 1.1 trillion during the period of 2010-20. See Bhattacharya (2010), "Estimated Demand for Infrastructure in Energy, Transport, Telecommunications, Water and Sanitation in Asia and the Pacific: 2010-2020", *ADB Working Paper* No. 248, September.



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Southeast Asian Economic Outlook 2010

The global financial crisis has offered an important opportunity for Southeast Asian countries to rethink past growth strategies and project new development visions. This inaugural edition of the *Southeast Asian Economic Outlook* looks at current efforts to rebalance growth for the region and at what form growth will take in the future.

The analyses and discussions presented in this volume highlight the need to implement five-year development plans with a view to rebalancing growth and instituting a credible fiscal policy framework conducive to greater fiscal discipline. In particular, well-designed fiscal rules, independent fiscal agencies and a medium-term budgetary framework are crucial elements. Although such institutions are becoming increasingly important across OECD countries, there is room for improving the institutional settings in Southeast Asia.

The 2010 *Outlook* also addresses the fact that the future development of Southeast Asian countries is likely to be uneven across sectors and economies, unless necessary measures are taken. Sectors of new growth in the region will need to be supported by going beyond the current narrow range of electronic products and developing more niche and speciality products that are priorities of the Association of Southeast Asian Nations.

Another area of policy action proposed is to develop more integrated transport networks. Given the huge investment needs for infrastructure development, new financing methods, such as infrastructure revenue bonds, should be further explored to promote public-private partnerships in the region.

The effectiveness of regional co-operation hinges largely upon its form. From the different options available, the *Southeast Asian Economic Outlook 2010* presents the OECD's peer review mechanism as a flexible instrument which may be suitable for policy dialogue and capacity building. Regional monitoring and surveillance based on peer reviews, including the support of macroeconomic policy co-operation, could potentially work well.