Economy

Trade

Growth

Asia Pacific: trading and thriving

December 2017

Foreword

Asia Pacific is a vast and diverse region, and one of the strongest performing parts of the global economy. GDP growth across Asia Pacific is forecast to hit 5.6% in 2017, well above the 3.6% projected worldwide, and 5.5% in 2018.[1]

Against this backdrop, the latest findings from Grant Thornton's International Business Report (IBR) reflect a buoyant mood across much of the region. Business optimism in Asia Pacific has hit a two-year high, driven by improvements from its two biggest economies: China and Japan. Elsewhere, in 2017 business optimism across the ASEAN (Association of Southeast Asian Nations) region hit its highest levels in six years.

What is driving this positive sentiment? As you would expect across such a large area, there are multiple contributing factors. The powerhouse that is the Chinese economy is becoming much more outward looking, reflected both in its One Belt One Road initiative and the movement of lower skilled jobs to neighbouring countries. This outlook is having a positive trickle-down effect across the region.

At the same time, our research shows there are signs that the ASEAN Economic Community, established in 2015, is boosting business growth opportunities. And the Trans Pacific Partnership, considered a non-starter following the change of administration in the USA, is still seen by many businesses leaders across Asia Pacific as an opportunity. These factors are reflected in confidence that free trade will prosper across the region over the next five years.

The outlook isn't wholly positive, however. As was the case in our last snapshot of Asia Pacific 12 months ago, businesses cite ageing populations as the biggest threat to the region over the next five years. Potential consequences of this trend include a shortage of labour supply and an impact on government investment, as more resource is directed towards services like healthcare and away from programmes which could benefit businesses more directly. Elsewhere, concerns about territorial disputes still worry Asia Pacific business leaders.

Looking ahead to the future, our research reveals a region feeling positive about its growth prospects - despite grappling with economic, cultural and political challenges.

Rodger Flynn
CEO, Grant Thornton Singapore

1 http://www.imf.org/en/Publications/REO/APAC/Issues/2017/10/09/areo1013

Outlook brightens across Asia Pacific region

The latest figures from Grant Thornton's International Business Report reveal that business leaders across Asia Pacific are at their most optimistic in over two years.

Levels of optimism hit net 41% in Q3 2017. This positive outlook is reflected in other indicators such as employment. Two in five (40%) businesses across the region expect to hire more people over the next 12 months, which represents a three-year high.

A striking shift in sentiment is evident in the two biggest economies across Asia Pacific. In China, business optimism has hit 52% - another three-year high. 44% of firms there expect to see revenues increase over the next 12 months, and 21% predict increased exports.

In Japan, where levels of business optimism are typically much lower, overall sentiment still sits in negative territory (-14%) but recorded a notable increase of 9 percentage points (pp) in Q3 2017 and is up 23pp from a year ago. Recent fiscal stimulus in Japan appears to be having a positive economic effect, as companies look forward to improved profitability (19%), and plan to invest in plant and machinery (40%) and new buildings (36%) over the next year.

> "Prime Minister Shinzo Abe's surprise decision to call a snap election in Japan paid off as he won by a comfortable margin. The hope for Japan will be that the certainty this brings will see business confidence strengthen further as we head into 2018."
>
> **Hiroyuki Hamamura**
> Managing Partner, Grant Thornton Taiyo Tax Corporation

Elsewhere, the ASEAN region is experiencing a surge of positive sentiment. Business optimism sits at 54% but reached 57% earlier in the year, the highest figure in six years. The impact of sustained economic growth in ASEAN is potentially significant; in 2014 the bloc would have been the world's seventh-biggest economy if it were one country. By 2050, it is projected to be the fourth-largest[2]. Robust domestic demand, driven by increased household purchasing power, has been identified as an important driver of growth expected to "accelerate"[3] in Southeast Asian economies this year.

Not all trajectories are heading upwards, however. In Australia, business optimism has slipped from 75% a year ago to 58% now. Optimism in New Zealand is down to 68% which is the lowest in two years. India is another economy where optimism still remains mostly positive overall at 78%, but has experienced a similar slide to Australasia, falling to its lowest level in four years.

> "In the last 12 months, businesses in India have had to deal with the impact of radical reforms such as demonetisation, country-wide consolidated indirect tax and a new bankruptcy regime. However, with the largest gain of any country in the 'World Bank ease of doing business ranking' and favourable macro-economic conditions, India remains one of the few bright spots in the global economy."
>
> **Vishesh C Chandiok**
> National Managing Partner, Grant Thornton India LLP

2 https://www.weforum.org/agenda/2017/05/what-is-asean-explainer/

3 https://www.imf.org/en/News/Articles/2017/05/08/NA050917-Asia-Dynamic-Economies-Continue-to-Lead-Global-Growth

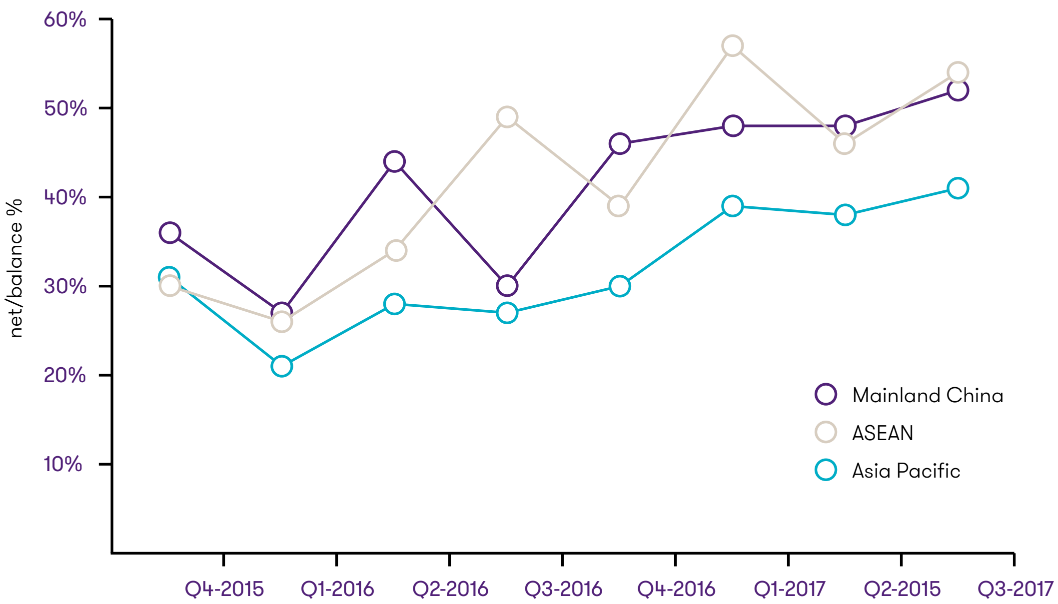
In China, just 10% of businesses expect increased investment in plant and machinery over the coming 12 months. The proportion expecting to increase R&D spend has also come off a relative high of 42% last quarter to 30%. Meanwhile, 87% of Japanese business leaders are concerned about a lack of skilled workers; more than any other country and an all-time high.

The picture these figures paint is one where on balance sentiment is positive – but it is not universal. This is reflected in the views of business leaders across Asia Pacific about their trade prospects. 50% of businesses across the region are confident that regional and geopolitical events will create a business environment that will allow free trade to prosper over the next five years. Only 6% are not confident this will be case. However, one in three (34%) remain neutral.

"Growth in China is strongly linked to the revival of its processing industry, where component parts are imported, assembled in China and exported to the rest of the world. As a result, close neighbours like Australia and Japan are increasing export expectations for the coming 12 months."

Rodger Flynn
CEO, Grant Thornton Singapore

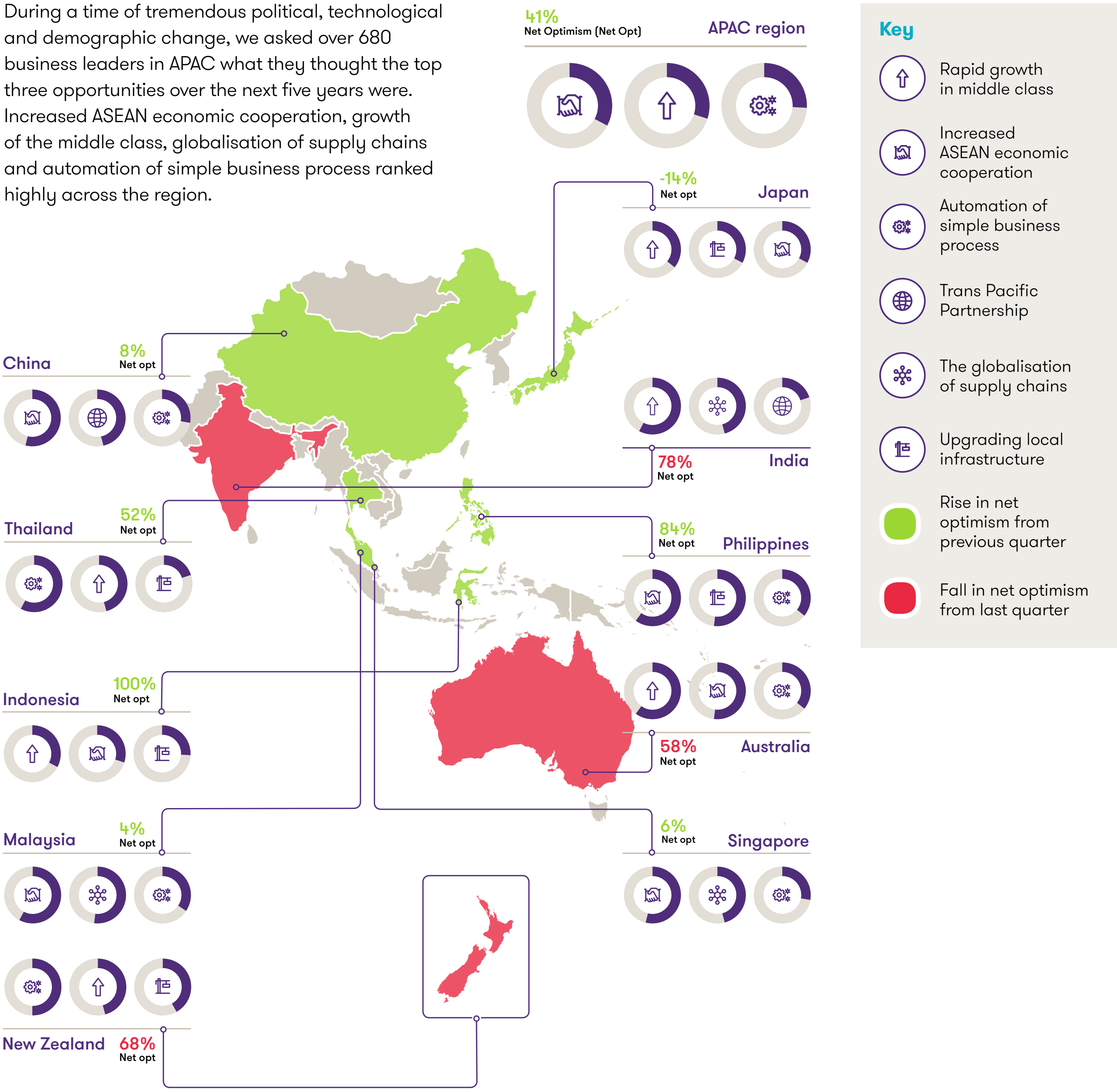
Figure 1: Net optimism



Source: Grant Thornton IBR 2017

Top three regional business opportunities*

During a time of tremendous political, technological and demographic change, we asked over 680 business leaders in APAC what they thought the top three opportunities over the next five years were. Increased ASEAN economic cooperation, growth of the middle class, globalisation of supply chains and automation of simple business process ranked highly across the region.



Source: Grant Thornton IBR 2017
*Top three opportunities over the next five years

Trade on the mind of Asia Pacific businesses

Amid broad based positivity, there are signs that enhanced cooperation between ASEAN nations is providing a particular boost for the region.

Businesses across Asia Pacific were asked to name what they considered the biggest growth opportunities for the region over the next five years. The most cited opportunity was increased ASEAN economic cooperation, cited by one in three (33%) business leaders. This is up 9pp on 2016.

Businesses outside the ASEAN region cited greater ASEAN economic cohesion as an opportunity. Firms in Australia (up 21pp on last year), China (up 14pp) and Japan (up 12pp) are particularly buoyant about the trend, which indicates that the ASEAN Economic Community, launched in 2015, is delivering tangible benefits both inside and outside Southeast Asia.

The Association of Southeast Asian Nations describes the establishment of the ASEAN Economic Community in 2015 as "a major milestone in the regional economic integration agenda in ASEAN, offering opportunities in the form of a huge market of US$2.6 trillion and over 622 million people".[4]

"The ASEAN Economic Community is a thriving and rapidly growing part of the global economy. Trade is central to the agreement, and it is positive that businesses inside and outside ASEAN see greater cooperation there as such a significant growth opportunity. Investors should remember though that ASEAN is a diverse region, with economies at different stages of development, so the right approach is essential."

Ian Pascoe
Managing Partner, Grant Thornton Thailand

The second biggest opportunity over the next five years cited by Asia Pacific businesses is the rapid growth of the middle classes. 30% cite this as an opportunity, up from 23% last year. A growing middle-class population represents a growth in consumers with spending power, and recent research has predicted that by 2030 Asia will represent 66% of the global middle-class population and 59% of middle-class consumption[5].

4 http://asean.org/asean-economic-community/

5 http://oecdobserver.org/news/fullstory.php/aid/3681/An_emerging_middle_class.html

"At Grant Thornton Malaysia, we are positive on the growth for the region – both for trade as well as investment. The major countries in Asia Pacific are all investing heavily in ASEAN countries and this will certainly spur the economy and employment. Malaysia plays a prominent role as the hub for South East Asia. With our multi-lingual and focused team, we continue to assist businesses to seize new opportunities for expansion."

Narendra Jasani
Country Managing Partner, Grant Thornton Malaysia

India has one of the fastest growing middle classes in the world. Our survey data shows that India's businesses are the most positive in the region (58%) regarding the opportunity presented by the increasing spending power of the rising middle class.

The third most cited growth opportunity (by 26% of firms) is the automation of simple business processes, freeing up workers for higher value-add tasks. As firms invest in technology-led solutions for lower skilled roles, there is confidence that this should also allow for greater efficiencies. However, the World Economic Forum's 2017 Global Competitiveness Index warned that many economies are ill-prepared for the next wave of automation, particularly in terms of "balancing flexibility with protection in labour markets" – reflecting fears that not all lower skilled workers will necessarily find work higher up the value chain. The index also finds evidence of productivity slowing down in advanced Asian economies[6].

Businesses getting into gear for China's One Belt One Road initiative

Across Asia Pacific, 46% of businesses agree that the One Belt One Road initiative will provide significant growth opportunities. Support for the initiative is particularly strong in India, at 66%, despite the Indian government objecting to the route of the trade belt, especially its path through Kashmir – ownership of which India disputes with Pakistan[8].

Support for One Belt One Road is lower in Australia (20% agree it will provide significant growth opportunities) and New Zealand (24%), countries which are not on the historic Silk Road and which perhaps expect to benefit less directly.

"One Belt One Road will require increased investment into infrastructure throughout the region which is likely to benefit Australian export of minerals during the initial establishment phase"

Greg Keith
CEO, Grant Thornton Australia

China's One Belt One Road initiative is a $5 trillion infrastructure programme that runs across Asia, the Middle East, Europe, and Africa. First proposed in 2013, the initiative is designed to connect countries along the modern-day equivalent of the Silk Road through trade, investment and infrastructure development. President Xi confirmed at a Belt and Road Summit[7] held in Beijing in May that 68 countries and international organisations had so far signed up for the project.

Hope lives on for the Trans Pacific Partnership

Despite uncertainty around the future of the Trans Pacific Partnership, 26% of businesses across Asia Pacific still see it as an opportunity for the region over the next five years. This is a slight increase from 12 months ago. The proportion of businesses who see it as an opportunity has fallen sharply over the last year in Australia (-40pp), New Zealand (-22pp) and Malaysia (-22pp), but it has risen in India (+17pp) and China (+10pp).

Earlier in 2017 the United States of America abandoned plans to join the trade deal, but the remaining members are still committed to an agreement and reports suggest a new deal without the USA could be finalised before the end of 2017[9].

6 https://www.weforum.org/press/2017/09/new-focus-needed-to-raise-global-competitiveness/
7 http://www.scmp.com/news/china/diplomacy-defence/article/2094410/china-hold-next-global-trade-summit-2019-xi-jinping
8 http://www.dnaindia.com/india/report-cannot-accept-project-that-ignores-core-concern-on-2437460
9 https://www.cnbc.com/2017/10/17/tpp-with-america-trade-deal-among-11-economies-may-be-coming.html

"Philippine businesses are increasingly optimistic about the national economy and plan to hire additional staff based upon an improving trade picture and increasing revenue expectations. Businesses will need to continue to invest in R&D and plant and machinery to capitalise on the region's continued prosperity."

Marivic Espano
CEO & Chairperson, Punongbayan & Araullo

Top challenges facing the APAC region according to our survey respondents

33%
Regional conflict regarding competing territorial claims

22%
Climate change and extreme weather events

33%
Ageing populations

16%
Fed reserve interest rate policy

32%
Rebalancing of China's economy

15%
Slowdown in demand for natural resources

23%
Automation of simple business processes leading to significant job losses

10%
Reshoring of manufacturing jobs by western businesses

Demographics and geopolitical threats still linger

While business leaders across Asia Pacific see lots to be positive about, threats still linger which could stifle growth if left unaddressed. The biggest threat to the region cited by businesses is the trend of ageing populations, down 3pp from last year at 33%, but the second year straight that it has topped the list.

The second biggest threat cited is regional conflict regarding competing territorial claims (33%). This is evidence that the threat of disputes escalating is weighing on leaders' minds as uncertainty over how the disputes will be settled affects the ability to plan effectively. Business leaders will have been encouraged by the Chinese President's recent commitment to "seeking a fundamental and durable solution"[10] to disputes with Vietnam.

The third biggest threat cited is the rebalancing of China's economy (32%), which is particularly acute in Japan (56%) and New Zealand (46%). Despite projections that China's GDP growth will remain steady at 6.7% in 2017[11], the concerns still raised by businesses serve as a reminder of the impact China's rebalancing is having on neighbours for whom the world's second largest economy remains a significant trading partner.

However, while the adjustment may create some concerns, change also brings opportunity. For example, as Chinese wage growth hits record levels[12], and as China moves up the value chain and takes on less labour-intensive manufacturing, that low value unskilled labour is transferring to neighbouring countries, including Cambodia and Vietnam. The surge in optimism in the ASEAN countries (+54% in Q3 2017) offers early evidence of a knock-on effect.

At the same time, China's growing middle class creates a cohort of millions of people with enhanced spending power, and a desire to travel and enjoy new experiences. Recent research[13] has found that the world's ten fastest growing cities for tourism are all in Asia, with the Chinese outbound market seen as a key driver.

> "The development of China's One Belt One Road initiative is linked to the rebalancing of its economy, and creates opportunities for businesses. Hundreds of billions of dollars of Chinese money are being spent on the development of railways, ports and power stations. The most dynamic companies across the region will already be looking to explore ways to make the most of this investment, whether that be enhanced credit availability or an increase in Chinese tourism – both business and leisure – along the route."

Rodger Flynn
CEO, Grant Thornton Singapore

10 http://www.scmp.com/news/china/diplomacy-defence/article/2119245/xi-jinping-calls-china-vietnam-work-together-settle

11 https://www.imf.org/en/News/Articles/2017/08/09/NA081517-China-Economic-Outlook-in-Six-Charts

12 https://tradingeconomics.com/china/wages

13 https://www.wttc.org/media-centre/press-releases/press-releases/2017/worlds-top-ten-fastest-growing-tourism-cities-are-all-in-asia/

Recommendations

Business leaders across Asia Pacific report healthy optimism, fuelled by the prospect of greater trade opportunities. But concerns remain which could threaten growth, if unaddressed. We make the following recommendations to help firms navigate the next five years successfully.

Ensure contingency planning in business forecasts to account for the global patchwork of trade agreements, operating on global, continental and regional levels. Business leaders believe such agreements offer significant growth opportunities but equally, with social and geopolitical forces able to reduce their scope, be wary of overreliance on trade initiatives to boost growth prospects.

Don't ignore threats posed by long-term demographic changes. Aging populations, for example, must be confronted rather than ignored. Consider partnering with schools and universities to ensure the skills needed tomorrow are being taught today. Also look for new pools of potential labour – including people looking for career changes later in their working life – in order to expand and diversify recruitment options.

Support for the One Belt One Road initiative is strong, but to make the most of the opportunity, understand the way business relationships are formed in China. Guanxi, as they are called, take time. Don't expect deals to be made unless significant effort and time has not been spent on building personal relationships first. Business relations with China have often failed because this time is not invested at the outset.

Automation of low skilled roles is a double-edged sword. Greater use of technology can boost efficiency, but if workers moved out of those roles cannot find new ones, unemployment could rise and create economic tension. Perform an audit of the roles currently at your organisation, the roles which will likely increase over the next five to ten years, and plot where technology could play a role and where people are best placed to contribute.

IBR 2017 methodology

The Grant Thornton International Business Report (IBR) is the world's leading mid-market business survey, interviewing approximately 2,500 senior executives every quarter in listed and privately-held companies all over the world. Launched in 1992 in nine European countries, the report now surveys more than 10,000 businesses leaders in 36 economies on an annual basis, providing insights on the economic and commercial issues affecting the growth prospects of companies globally.

The data in this report are drawn from 686 interviews conducted between August and September 2017 with chief executive officers, managing directors, chairmen and other senior decision-makers from all industry sectors in mid-market businesses in 10 Asia Pacific economies.

The definition of mid-market varies across the world: in mainland China, we interview businesses with 100-1,000 employees; in the United States, those with US$20million to US$2billion in annual revenues; in Europe, those with 50–499 employees. For the purposes of this research senior management is defined as those holding C-suite jobs, such as chief executive officer (CEO), chief operating officer (COO) or chief finance officer (CFO), managing directors or partners.

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