Southeast Asia in 2021: three economic themes to watch

Blog post by Senior Associates Andrew Yeo and Jens Presthus, 2 February 2021

There is no country in Southeast Asia that has escaped the impact of covid-19 unscathed, although the intensity of the pandemic's disruption and individual countries' abilities to adapt have varied significantly. Early government intervention to restrict international travel and the implementation of strict lockdown measures meant that in terms of covid-19 cases, Southeast Asia has generally fared better than in many other parts of the world. While the region comprises of about 9% of the global population, it has only recorded around 2% of the total cases and deaths. However, this does not mean that the region has managed to escape the crippling economic impact of the pandemic.

To frame the economic outlook for Southeast Asia in 2021, we explore three themes which will have implications for corporates and investors with an interest in the region.

The first is the prospects for the resumption of tourism, which is intrinsically tied to vaccination strategies. Southeast Asia is geographically characterised by its sprawling island nations and key mainlands. Indonesia and the Philippines are classic archipelagos, but island living is also an essential part of swathes of Malaysia, Thailand and to a lesser extent, Vietnam. This complicates vaccine distribution in a region already marked by its inefficient bureaucracies. The danger of another wave of infections should also not be discounted. Governments in Southeast Asia have also adopted varying procurement, vaccination targets, and rollout strategies, all of which will be elaborated on in the second article of this series.

This has dampened the prospects of a Southeast Asian travel bubble, which Indonesia has been lobbying hard for. Instead, it is the East Asian countries of China, Japan, South Korea and Taiwan, which are in discussion with select Southeast Asian countries such as Singapore and Vietnam for the establishment of bilateral travel corridors. To compound matters, the pandemic's impact on the region is also borne disproportionately by several of these countries which have long relied on tourism dollars as a bulwark for their economy. Tourism in 2019 contributed to 15.9% of Malaysia's, 20% of Thailand's GDP and 13% of the Philippines' GDP respectively. With optimistic forecasts for the resumption of mainstream leisure travel to resume in the region at some point in 2022, the economic outlook for these countries is grim.

Second, debt levels rose dramatically in 2020 and governments have few economic levers left to generate revenue streams. General government debt as a share of GDP has increased across the board, although it remains at relatively modest levels in most countries. The Philippines saw a jump from 34.8% in 2019 to 47.8% in 2020, while Thailand's 2020 debt to GDP ratio increased by 9.3% to 45.2%. In August 2020, Malaysia's parliament approved raising the government debt ceiling to 60%, the first time it had done so in more than a decade. And the country's finance minister has already mooted the possibility of raising it to 65% in 2021. A relatively nascent but promising source of revenue is digital taxation, which has been introduced in different forms in many Southeast

Asian markets. As it stands, Singapore, Vietnam, Thailand, the Philippines, Malaysia and Indonesia are in some form or another trying to tax either service providers or cross border ecommerce transactions.

Fig 1: New lockdowns are subduing activity

Retail sales yoy growth, %

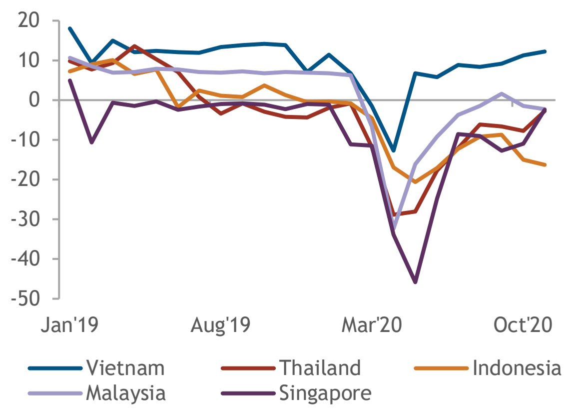
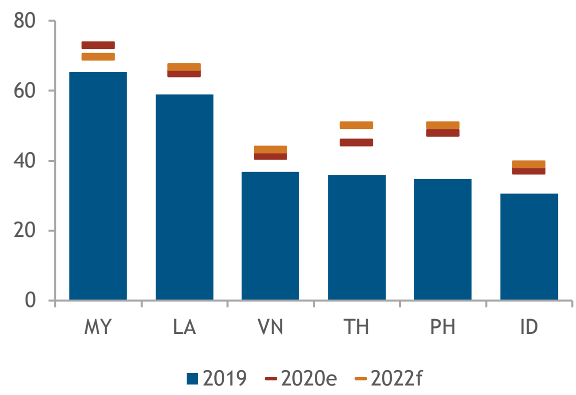


Fig 2: Debt levels are rising

General government debt, % of GDP



Sources: CEIC, Fitch

The characteristic central bank response has been further rate cuts, although the Philippines and Indonesia have ventured into debt monetisation. The former's central bank purchased $6 bn worth of government bonds in March 2020 while the latter bought up 22.8 trn rupiah in May 2020. While the purchases have been pitched as temporary moves, there are growing concerns about moral hazard in financial markets and government interference in monetary policymaking.

However, it is not all doom and gloom. Singapore has worked furiously to extend its lead as the region's most digitally advanced financial hub. Singapore's penchant for international agreements remains unabated, even if the new normal of covid-19 means formulating the rules for digital trade becomes a priority. The country has over the course of a year secured pioneering digital economy agreements with Chile, New Zealand and Australia, fostering interoperability and trade between its signees.

Singapore has also awarded digital banking licenses under a new regulatory framework encompassing, amongst other factors, the need for such banks to demonstrate a pathway towards profitability. The raison d'etre for these digital banks will not be Singapore itself, but leveraging their reach from the island nation to steal a march over global competitors into Southeast Asia's estimated 290m unbanked population. Malaysia – some would say in response – has similarly pledged to issue up to five digital banking licenses by 2022, while Gojek's foray into digital banking in Indonesia despite the lack of regulatory clarity means we expect Indonesia's Financial Services Authority to be working on its own framework too.

The last theme is the reconfiguration of global supply chains and its impact on Southeast Asia. The trend of companies shifting production of out China, while not ignited by covid-19, has certainly been accelerated by it. The risk of overdependence on a single manufacturing jurisdiction is now salient and comes in addition to pre-existing reasons such as rising labour costs and US tariffs.

Manufacturing bases in Vietnam and to some extent the Philippines will benefit from different variations of the China Plus One strategy that some corporates are adopting to diversify from China-centred supply chains. Vietnam has logistical advantages as they share a border with China, even if its ports lack quality seaport infrastructure. Unfortunately, the comparatively lower technical levels in the labour force of these countries will also mean that higher value, knowledge-intensive manufacturing in the near term will still be borne out of the traditional hubs of China, Singapore, Thailand and Malaysia. Several of these countries are also roiled in domestic political troubles, which we aim to cover in more depth in the third part of this series.

This blog is part of Global Counsel's "Southeast Asia in 2021" three-part series, where our Singapore office takes a close look at the region's political and economic drivers for the year, focusing on the key issues that will affect the region's recovery from the pandemic. The next piece in this series will cover the vaccine rollout in Southeast Asia.