NBR Special Report Doing business with Asia's other billion

Millions of people are entering the middle class in Asia Pacific. New Zealand is in an enviable position to leverage this emerging consumer base, so where should businesses look in Asia? NBR lays out Asia as the world's fastest-growing region.

Nathan Smith

How 2015 will look for Asia Pacific

NBR's Asia feature last year laid out an annual forecast for countries excluding China. This year the feature will assess those predictions before turning its attention to the next 12 months.

Three dominant expectations were isolated in 2014. First, China would struggle to reform its economy amid slowing growth. Second, other major Asian powers would respond to China's growing influence. Third, some developing states would become volatile as China slows and US monetary policy alters.

China did experience slowing economic growth in 2014, reaching GDF growth of 7.4%, down from 7.7% in 2013. Other Asia Pacific countries are steadily capitalising on a slowing China. Growth of about 5.5% is still expected in the region in 2015. Tightening global liquidity also remains a concern for regional stability in some economies.

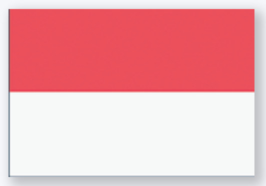
Looking to the year ahead, China's graduation to a consumer economy will see it hover near 7% GDP growth. Second, serious movement will be made to integrate Southeast Asia into a stronger regional community. Third, limited regional growth will benefit from low oil prices while struggling to contain political instability.

Low energy prices will be the central story in Asia for 2015 as each country takes advantage to boost GDP. However, countries with domestic energy sectors will see declines in revenue and potential cancellation of exploration and development contracts.

The US is also experiencing slower-than-expected growth, registering only 1% in the first quarter of 2015. This limits the likelihood of an increase in interest rates higher than 0.25% where they have stayed since 2008-2009. Although the US is unlikely to restart quantitative easing, a stuttering US economy may alter the growth calculations for the Asia Pacific.

NZ's top 3 trading partners

INDONESIA (pop: 255 million)



Cheaper energy prices will affect Indonesia in different ways. The island of Java, Indonesia's heartland, will experience the greatest boon. The island houses 70% of the country's population and the vast bulk of its factories. Other parts of the archipelago will suffer from low oil prices. Sumatra, East Kalimantan and Sulawesi rely on energy resource extraction to maintain the local economy. President Joko Widodo won the election as predicted in 2014. He began his first term with vigour, overhauling the costly fuel-subsidy programme. However, government effectiveness will be limited as he struggles to sustain political authority. Mr Widodo's fuel subsidy reductions offer Indonesia a buffer to expand its dilapidated and inadequate infrastructure and social services should oil prices remain low. It also provides a healthy base for consumption growth. Total GDP growth for Indonesia is expected to reach 5.2%.

JAPAN (pop: 126 million)

The Liberal Democratic Party easily defeated competition in snap elections last December. The LDP's leader Shinzo Abe will now be in power for the next four years. Mr Abe will use a strong position to push through politically sensitive structural and economic reforms important for managing the first two "arrows" of his so-called Abenomics strategy – monetary easing and fiscal stimulus. Japan's agricultural lobbies are also firmly in his sights as tension over the Trans Pacific Partnership FTA rises. Low energy prices will benefit Japan as it currently relies heavily on fossil fuel imports. Japan may reinvigorate its nuclear energy portfolio, with attempts to change public opinion. Japan is also expected to deepen ties to the Association of Southeast Asian Nations (Asean). Improved consumer sentiment and sustained export growth is expected to push Japan's GDP up 1.3%.

SOUTH KOREA (pop: 49 million)

Southeast Asia will continue attracting serious investment interest from South Korea in 2015. New Zealand and South Korea signed a free-trade agreement to boost trade ties. South Korea and China may agree on a FTA this year but other talks have stalled over a tripartite agreement between South Korea, China and Japan. Both agreements reflect the interdependency of the three Asian heavyweights. At home, president Park Geun-hye's approval ratings slipped after a series of negative events last year, although she will remain leader until 2017. Economic growth has been due to high household debt and weak exports, a situation predicted to ease if the FTA deals pass. Ms Park is pursuing her "creative economy" agenda to fix structural challenges to South Korea's economy. However, given the inherent lag in economic alterations those polices will take time for significant impact on the economy to filter down. GDP growth will reach 3.7%.

Asia's other billions

BANGLADESH (pop: 158 million)

With domestic demand in Bangladesh recovering as activities normalise following a year of political unrest, the country should experience swift growth. Although the current government should complete a full term, political tensions may deter higher foreign investment. The opposition party will pressure the administration but snap elections are not expected. Bangladesh should grow by 6.8%.

BRUNEI (pop: 423,000)

Politically, the sultanate of Hassanal Bolkiah Mu'izzaddin is not expected to meet serious challenge over the next year. Brunei exports more than 70% of its GDP as oil and gas, so low oil prices will diminish Brunei's trade surplus, pushing its budget into deficit. Any resulting unrest should be contained with the tiny country. Should energy prices recover, Brunei's GDP will grow by 2.3%.

BURMA/MYANMAR (pop: 53 million)

The country will seek to secure some accommodation with rebel groups as part of its optimistic process of long-term economic "reform and opening." A deal will, however, remain distant this year. Aung San Suu Kyi's National League for Democracy party should do well at the election in October-November, if the election is free and fair. Myanmar's GDP growth should reach 7.8%.

CAMBODIA (pop: 15 million)

Falling global energy prices will benefit Cambodia, which imports all 43,000bpd of oil. Both the ruling CPP and the opposition CNRP parties are willing to cooperate on electoral reform following significant political strife in 2014. Along with strengthening external demand for its garments and higher domestic consumption due to low inflation, Cambodia looks set to grow by 7.3%.

LAOS (pop: 6.8 million)

The ruling Lao People's Revolutionary Party should win the National assembly election in 2016, stabilising the country as a one-party state. Civil service pay has been halted to address the country's fiscal debt. However, a large current account deficit will be recorded this year. GDP growth will rise to 7.6% supported by rising tourism and the recovery of the neighbouring Thai economy.

MALAYSIA (pop: 30 million)

As a net oil exporter, Malaysia is most at risk from falling oil prices. Not only will it affect oil exporters but the dip will tighten the government's coffers, which earned 29.5% in 2013 from taxes on energy exports. Prime Minister Najib Razak is expected to retain his position until 2018. Domestic demand will remain the engine of Malaysia's growth, which will grow 5.6%.

MONGOLIA (pop: 2.8 million)

Should two massive mining deals with Rio Tinto – developing the Oyu Tolgoi mine and the Tavan Tolgoi coal mine – succeed, Mongolia will see significantly increased GDP growth. If the shaky deals do go ahead, the landlocked country may reach 11% growth this year.

PAPUA NEW GUINEA (pop: 7.4 million)

Rapid growth fuelled by a liquid natural gas boom will propel Papua New Guinea's economy to an estimated 15% growth. Once again, low energy prices may negatively affect government revenues although an enormous LNG refinery has come online since 2014. Political instability, however, could return as prime minister Peter O'Neill fights off scandals over alleged illegal payments.

Photo: Antonina Elliott

EMERGING ECONOMIES: Low oil prices will affect Southeast Asia in a variety of ways, not all negatively

THE PHILIPPINES (pop: 100 million)

The central government still battles rebel Muslim groups in the south of the country. The popularity of President Benigno Aquino has suffered from military operations against the rebels, one of which resulted in the deaths of 44 police commandos. Infrastructure development will remain a top priority along with greater employment generation. Boosted by post-typhoon spending, private consumption will help grow the economy by 6.7%.

SINGAPORE (pop: 5.5 million)

The death of Singapore's founding leader, Lee Kuan Yew, makes the future of the ruling People's Action Party uncertain. Geography and strict immigration laws will constrain Singapore's labour pools. And with expanded welfare benefits for elderly and low-income workers, Singapore will struggle to cover rising costs. A higher tax on the top 5% of earners will assist in reaching 3.8% GDP growth.

THAILAND (pop: 67 million)

Unity and cohesion remain priorities for a government still reeling from recent political unrest. A looming royal succession indicate elections are unlikely this year. Nevertheless, the military remains in control, stabilising Thailand's politics. Large infrastructure projects and minor political reforms will see a rise in GDP of 4.2% after a sharp slip in 2014.

TIMOR LESTE (pop: 1.1 million)

New prime minister, Rui Maria de Araújo, will lead a national unity government. However, low oil and gas output will hamper GDP growth this year expected at -0.7%. As energy prices decline, Timor Leste's oil investments will provide a diminished income stream sufficient to cover a budget deficit.

VIETNAM (pop: 92 million)

While the country's economic expansion continues apace with a 6% GDP rise predicted, Vietnam's energy outlook is less certain. The benefits of cheap oil will be positive for consumers and industry but could hurt government revenues. But low oil prices should keep Vietnam's monetary policy in check. The economy continues to diversify its exports and new regulations should help encourage investment activity.

OCEANIA (pop: 3 million)

Fiji Last year's election cemented Voreqe (Frank) Bainimarama's place in Fiji's politics. The largely democratic election will improve its foreign relations. Both a rising consumer base and heightened investment, along with a continually developing tourism sector, will lift the country's GDP to 3.2%.

New Caledonia The territorial government collapsed in December over fiscal reforms only six months into a five-year term. The reconfirmed government of Philippe Germain's Caledonie party may now improve stability. The country's nickel mining, and financial transfers from France, will boost GDP by 3.2%.

Samoa The political situation is likely to remain steady over the next few years as the ruling Human Rights Protection Party should win elections in 2016. Consumer prices are predicted to surge due to a depreciating tala while inflation will rise. A contraction in the agriculture, construction and manufacturing sectors continues, slowing Samoa's GDP growth to 1.4%.

The Solomon Islands The government of prime minister Manasseh Sogavare's Democratic Coalition for Change still struggles to find an alternative to the country's overdependence on logging. Forests remain near exhaustion. Progress on reforms will be hampered, however, by the administration's limited capacity while political loyalties to Mr Sogavare are tenuous. Its GDP will expand by 4.1%.

Tonga Recently elected Samiuela 'Akilisi Pohiva wishes to implement minor political reforms but will be constrained by the country's reliance on foreign aid. An increase in tourism and remittances, including some new construction projects, should however bump the country's GDP to 2%.

Vanuatu Cyclone Pam smashed parts of the island chain in March causing widespread damage. International relief efforts are in process but building damage will isolate aid and construction work in the year ahead. Many industries are affected, including tourism, and GDP will rise only 4%.

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Asean takes next step to single market

Gary Cross

From a business perspective, Southeast Asia has long been an interesting but unsynchronised collection of smaller markets. That is rapidly changing.

More than 11 years in the making, the Asean Economic Community (AEC) will come into existence on December 31, 2015, fulfilling the dream of a single market and production base encompassing the 10 members of Asean, the Association of Southeast Asian Nations.*

An economically unified Asean will represent a market of 640 million people with a combined GDP of $2.4 trillion: if it were a nation it would be the world's seventh largest economy, 25% larger than India. McKinsey forecasts the number of middle-class households will more than double to 163 million between now and 2030.

The road to the AEC has been long but the celebrations at the end of this year will not mark the end of the journey. The latest AEC scorecard came out in 2012 and estimates member nations had achieved 67% of their integration targets by that date.

Further progress has been made since then but some of the most thorny issues – including free trade in food products and key service sectors – remain works in progress.

Asean is also spectacularly diverse, making the creation of a one-size-fits-all market even more challenging. GDP per capita in Singapore, Asean's richest member, is more than 20 times that of Myanmar, its poorest; it embraces everything from an absolute monarchy to nations with roots in communism; and it is founded on the principle of non-interference, which means all members have to agree on measures before they can be implemented.

But even if the AEC will not be perfect and fully formed, its establishment will mark a milestone by underlining its members' commitment to walking a one-way path to greater integration.

The pace of convergence has recently accelerated as the potential synergies – the opportunity to create something that is substantially greater than the sum of its parts – become clearer.

The region's diversity is a challenge but it is also an unmatched opportunity for self-sustaining growth: there are resource suppliers and resource consumers; high-value added producers making the goods that aspirational high-volume, low-margin producers want and vice versa; and there is a clear understanding that together they can take on the world's biggest producers and markets on their own terms.

But to achieve this, Asean needs to maintain the momentum toward integration. The final steps to a common market will be the hardest because they will have the most impact on domestic interests. They will also be the most important if the region is to fulfil its aims of sustainable and equitable growth.

Three priorities

There are three interlinked priorities: trade connectivity, financial connectivity and physical connectivity.

The group needs to keep up the pressure to dismantle tariff and non-tariff trade barriers, including for services industries. Much of Asia's new growth, particularly in middle-income countries like Thailand and Malaysia, is going to come from the services sector and progress will be both faster and more stable if it can draw on a regional rather than national talent pool.

This is particularly important when it comes to financial services. Frictionless cross-border banking will facilitate the growth of supply chains, both in terms of geographic breadth and skills depth, and will allow the pooling of assets for vital investments in the next phase of growth.

And that means infrastructure. Without significantly more investment in the physical hardware of connectivity – the roads, railways and ports that make trade possible – and the financial architecture to pay for it, the dream of a self-sustaining Asean economic powerhouse will never be fully realised .

The need for more and better infrastructure is widely recognised but the region is struggling to find a sustainable way to pay for it. Asia has traditionally relied on bank loans for the bulk of its financing needs but the scale and duration of the demand for infrastructure investment puts it in a different league.

Asean needs deeper, better-connected and more efficient local debt and equity capital markets to transform its savings into investment for its next phase of growth, and it needs a harmonised regulatory system to protect both lenders and borrowers.

Although December 31 will be an important milestone in achieving full AEC vision, it is neither the beginning nor the end of the process. The community's framers can look back at their achievements with pride but it is more important that they look forward with determination.

** Asean: Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam*

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"Given Asia's largely liberalised trade regimes, narrowing the infrastructure gap would do more to reduce trade costs and increase volumes than eliminating remaining tariff barriers." www.adb.org/publications/asian-economic-integration-monitor-november-2014 p27

World's top globetrotters

Nevil Gibson

The Australasian-South Pacific aviation market is considered a mature one but the region is also considered to have the world's highest propensity to travel per capita.

At three trips a head each year, that is almost double that of North America and it will remain the world's highest at over four trips a head by 2033.

The figure comes from Airbus' latest Global Market Forecast, which shows international traffic to and from neighbouring and developing countries in Asia will increase at an annual rate of 5.1%. This compares with the world average of 4.7% and 4.5% within the Australasian-South Pacific region.

Today, some 70% of world air traffic is within the wider Asia Pacific region, which is set to produce 40% of the world's GDP output by 2033.

In the next 20 years (2014-2033), the overall passenger and freighter fleet will increase from 18,5000 aircraft to 37,500 , an increase of nearly 19,000.

Other projections in the report show Auckland will be one of 91 world aviation mega-cities, which will account for 35% of global GDP and will be served by high-capacity aircraft, with some 95% of all long-haul traffic travelling to, from or through them.

Some 12,400 older and less fuel-efficient aircraft will be retired during this period.

The latest International Air transport Association Airlines Financial Monitor shows air transport volumes continue to expand at a robust rate.

"The decline in oil prices should help support economic activity and passenger demand in 2015. In addition, recent improvement in business confidence in some advanced economies should help support growth in international travel," it says.

Air freight volumes fell in March, after an unusually strong February spike due to temporary factors. Despite the fall in volumes, the levels of freight carried per kilometre were still above those in January and continued to show upward growth.

The region's largest airline, Singapore Airlines, has said the immediate outlook "remains challenging amid an uncertain global economic outlook."

Its annual report for the March 31 year adds: "Competition remains intense as other airlines continue to inject capacity with aggressive pricing."

Nevertheless, the parent airline and its three associated companies, regional operator SilkAir and budget airlines Scoot and Tigerair, have all increased or maintained their fleets while adding destinations.

SIA Cargo, which has eight Boeing 747-400 freighters, is expected to increase its capacity 3-4% in the coming financial year.

"Despite global air cargo demand showing early signs of recovery, cargo yields are expected to remain under pressure due to excess capacity," it says.

Auckland and Christchurch connect to the Singapore hub with 19 round-trips a week, including an Airbus A380 service to Auckland. These are run in a codeshare with Air New Zealand and connect passengers and freight with 60 other destinations in 34 countries.

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Shippers grapple with excess capacity

Nevil Gibson

Container shipping companies, which move more than 95% of the world's manufactured goods, are still struggling against worldwide over-capacity but shipbuilding orders suggest positive signs for the future.

The world's largest container company by capacity, Maersk Line, expects global demand for seaborne transportation to increase between 3-5% this year, well below an estimated 20-30% excess tonnage in the water in the world's busiest trade routes.

Danish-owned Maersk is counting heavily on its recent alliance with Switzerland's Mediterranean Shipping Company to cut operational costs by as much as a combined $US1 billion annually through the sharing of vessels, trade networks and port calls.

The combined strength of such operators is likely to force smaller competitors out of the main trade lines over the next three years, industry analysts say, as they won't be able to compete in terms of cost and capacity.

The so-called 2M alliance with MSC moves 15% of cargoes on routes across the Pacific as well 35% of all cargo between Asia and Europe.

The nearest rival, Ocean Three (France's CMA CGM, China Shipping Container Lines and United Arab Shipping) controls 13% of Pacific traffic and 20% between Asia and Europe.

Reports in Asia say Maersk has voted in the future by placing an order of 10-11 container megaships from Korea's Daewoo Shipbuilding & Marine Engineering in a deal worth more than $US1.5 billion.

It will be the first time since 2011 that Maersk Line has returned to the market for ships of this size. Back then, it placed an order with the same Korean shipbuilder for 20 so-called Triple-E ships, which carry in excess of 18,000 containers each.

The last two vessels from that order will be delivered to Maersk by July.

The new megaships will be mainly used in the Asia-to-Europe trade by the 2M alliance.

The company's latest financial result said the industry was more competitive than ever with an increasing supply/demand gap.

"This quarter we were helped by the oil price and exchange rate," Maersk Line chief executive Søren Skou said.

"But we cannot always rely on external factors to achieve good results. We must therefore remain focused on doing even more on our cost leadership and continue to improve and deliver the products our customers demand."

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Mastering etiquette isn't easy

Nathan Smith

It's tempting to assume Asia is somehow a magically homogenous region, but this simply isn't the case. Even working only a short stretch in the Asia Pacific, New Zealanders quickly discover the worst thing they can do is generalise.

A couple of culture threads do run through the region however, such as hierarchy and the concept of luck, but it's the idiosyncrasies which truly differentiate the nations.

James & Wells head of Asia Johnathan Chen says Japanese businesspeople for instance don't arrive anywhere without wearing a suit and tie.

"The commonality in Japan is the idea of social status. Everything from clothing to the meeting venue to the golf club membership are important to the Japanese.

"And never refer to the company boss by their first name. Taiwan and Hong Kong are the same, as is Malaysia and Singapore," Mr Chen says.

New Zealand Trade and Enterprise regional director East Asia Shaun Conroy says business culture in Asia is built on respect, good manners and responsiveness to customers.

"The major pillars of most Asian cultures are respect, hierarchy, age, family business culture, pace of business and the primacy of the buyer. In Asia relationships are slow, business is fast. Once relationships are formed they can be lifelong," he says.

In Asian culture, long legal contracts take a back seat to relationships. Presenting an Asian business partner with a 60-page boiler plate legal agreement isn't the best thing to do, he says. Every point may be discussed and negotiated.

"A one or two-page memorandum of understanding will generally progress things faster. If you are selling, keep it simple."

For instance, a traditional contract in Japan or Korea might contain a clause which states: "If conditions change the parties agree to renegotiate the terms".

"This might seems like a contract-killer but in their minds – as with families – the relationship is more important than the contract.

"As with a family you need to be able to address the other parties' problems and vice versa if the positions are reversed," Mr Conroy says.

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