

# Chapter VI

## Economic Forecasts of ASEAN4

### Issues in Continuing High Growth of Malaysia and Thailand

As explained in Chapter 2, the ASEAN4 may be divided into Malaysia and Thailand or the countries called the “middle income group” and Indonesia and the Philippines which are starting to industrialize and grow fast thanks to foreign direct investment (FDI). The issue which the first group will face in the next 10 years will be the continuation of the high growth with stable prices. As shown in Table 2, the per capita income of the group is less than half that of the NIEs. In view of this, a “high economic growth” for the group may be said to be about 7.5 percent and “stable prices” an inflation rate of 3 to 5 percent.

To sustain such “high growth”, the first group, that is, Malaysia and Thailand, has to improve and expand their infrastructure. In the high growth period of the past 10 years, the two countries have engaged in infrastructure building making use of private investment such as BOT or BOO<sup>12)</sup> schemes in addition to government investment in order to cope with their poor infrastructure. The economic forecasts for Malaysia and Thailand for 1996 to 2005 assume that infrastructural building will continue growing at the same pace as the past 10 years through investment by the government itself or private sector investment.

The first group requires not only infrastructure building, but also greater sophistication of the industrial structure. This reflects the fact that the second group, Indonesia and the Philippines, along with China are industrializing using their inexpensive labor and FDI and are fast on the heels of the first group.

What should be noted in regard to the influx of FDI required for boosting the sophistication of industry are first, the sharp 87 percent rise in FDI approved by Malaysia in 1996 and the similar surge in approved FDI in Thailand. Foreign investment in Thailand other than FDI (indirect investment), however, dropped off considerably in early 1997. On July 2, Thailand switched to a floating exchange rate for the baht, but it should take one to two years before confidence in the baht is restored and foreign indirect investment begins increasing again.

### Changes in Industrial and Export Structure

Malaysia and Thailand both suffered a sharp drop in nominal growth of exports of goods in 1996.<sup>13)</sup> Thailand, in particular, saw its nominal exports of goods fall, though by just 0.2 percent, in 1996 – triggering the 1997 baht crisis. A look at the goods which Thailand exported in 1996 however shows that while there was a major decline in exports of labor intensive manufactures such as textiles, apparel, footwear, and plastic products, there was also a surge in exports of capital and equipment intensive items such as electronic components and apparatuses which substantially cancelled this out.

True, at the time of transition to a floating exchange rate, the Thai baht was pegged at 31 to the dollar or about 20 percent less than the 25 to the dollar of 1996. The international competitiveness of labor intensive goods will consequently recover. In the long term, however, along with the rise in the per capita income, the country will move up from the traditional labor intensive type industries to capital and equipment intensive industries such as electrical machinery, electronics, and transport machinery. Malaysia is already increasing the sophistication of its growing electrical machinery and electronics industries relatively smoothly along with the rise in its per capita income.

Reflecting this adjustment in the structure of industry and exports, as shown in Table 4, the real rates of growth expected for exports of goods and services of Malaysia and Thailand will be 12.2 percent and 9.0 percent a year in 1996 to 2000 respectively, or substantially less than the average annual growth rates for 1986 to 1995 (15.0% and 17.0%). In particular, Thailand's exports continued sluggish in 1997 as in the previous year. It probably will not be until 1998 that double-digit growth (of real exports) is attained. Due in part to this, there should be an average annual 9.0 percent growth in Thai exports in 1996 to 2000 or an 8 point drop compared with the rate of increase of exports in 1986 to 1995.

Malaysia and Thai exports should recover in growth in 2001 to 2005 rising an average annual 13.0 percent and 12.0 percent respectively from the previous five years (see Table 4).

Compared over 10 years, in 1996 to 2005, Malaysian and Thai exports should rise respectively by an average annual 12.6 percent and 10.5 percent or 2.4 and 6.5 points below the actual average annual growth for 1986 to 1995.

The sustained high growth over the past 10 years (see Table 1) created rising inflationary pressures and ballooning imports in Malaysia and Thailand in 1996. Thailand therefore changed over to a floating exchange rate for the baht in July 1997 (de facto devaluating the baht) and is trying to tighten up on fiscal spending and shifting to tight monetary policy. Malaysia is also adopting a more austere fiscal and monetary policy at least at the start of 1996 to 2005.

### 7 Percentile Growth and Stable Prices for Malaysia and Thailand

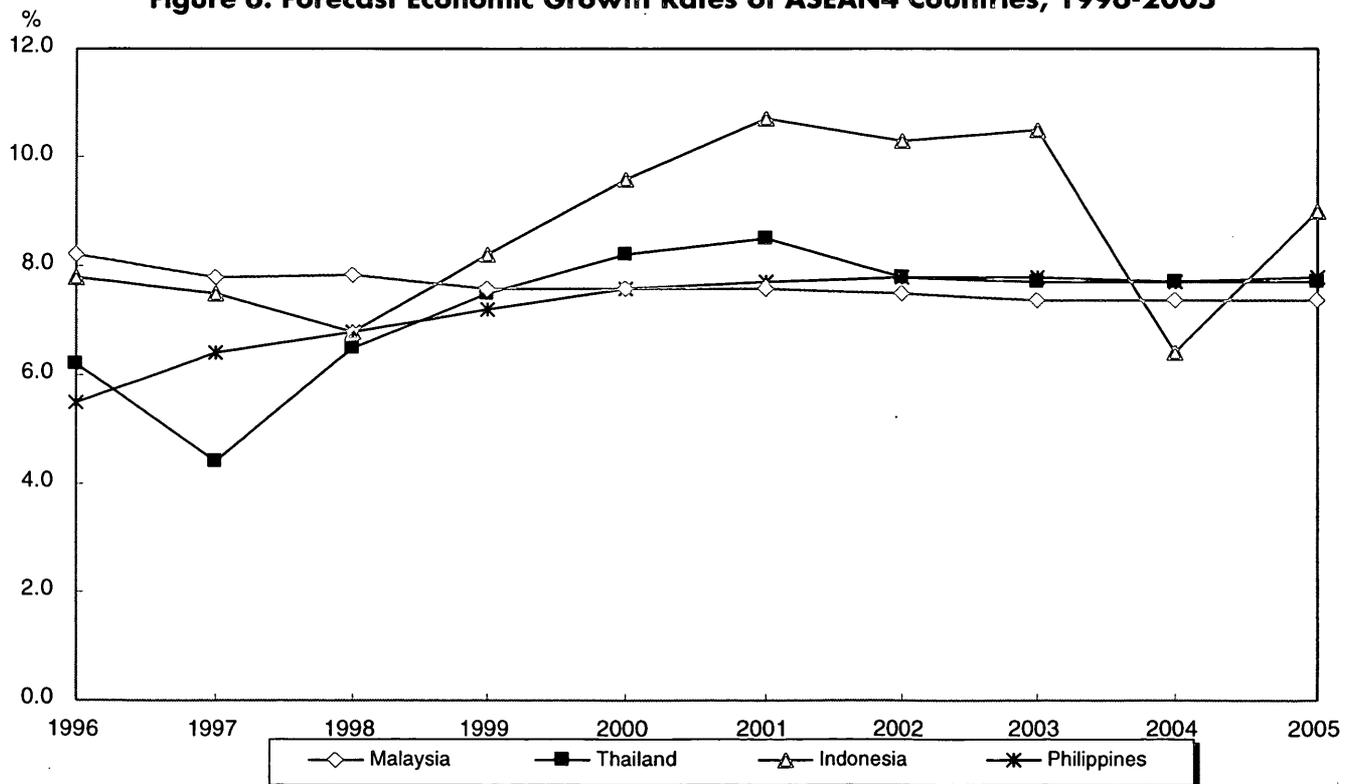
Economic forecasts were made for Malaysia and Thailand for the years 1996 to 2005 based on the above assumptions. The results are shown in Table 5 and Figure 6. The average annual rates of economic growth for different time frames are shown in Table 6 and the rates of inflation in Table

7. Malaysia is forecast as having a strong annual 7.6 percent<sup>14)</sup> rate of growth with a stable annual 3.7 percent inflation rate.

The Thai economy will suffer from poor investment due to the drop in the flow of foreign capital caused by the instability of the currency. Economic growth in 1997 and 1998 will slow to 4.4 percent and 6.5 percent. The Thai economy should recover to 7.5 percent growth in 1999 and to the 8 percentile level in 2000 and 2001. After this, it will decelerate to the high 7 percentile range. The average annual growth rate for Thailand from 1996 to 2005 is forecast as being 7.2 percent or a 2.2 point drop from the 9.4 percent average annual rate of growth for 1986 to 1995, but Thailand will achieve a fairly strong economic growth in the next 10 years.

The rate of inflation for Thailand for 1996 to 2005 is estimated as rising an average annual 5.3 percent – a high level but including the short term inflationary period of 1997 and 1998 due to the rise of import prices caused by the de facto 1997 devaluation of the baht. While 0.5 point higher than the annual 4.8 percent inflation from 1986 to 1995, it can still be said to be a substantially stable level.

**Figure 6. Forecast Economic Growth Rates of ASEAN4 Countries, 1996-2005**



Note: Figures are from Table 5.

Thailand will record a 0.4 point lower average annual rate of economic growth compared with Malaysia in 1996 to 2005 due to the slowdown in the Thai economy caused by the insufficient inflow of foreign capital in 1997 and 1998.

### **Indonesia and Philippines Aggressively Introducing FDI**

The per capita incomes of Indonesia and the Philippines were still in the US\$1000 range in 1996 (see Table 2). Due to this, these two countries are classed as the “second group” of the ASEAN4. There has been a considerable difference in economic performance of the two in the past 10 years (1986 to 1995) however. A look at Table 6 shows that while Indonesia achieved a high 7.8 percent average annual growth rate during this period, the Philippines scored only a low 3.4 percent. This was due in part to the fact that the Philippines was in the middle of considerable political upheaval during the period, was struck with natural disasters, and was slow to effectively ease restrictions on FDI.

From 1996 to 2005, the second group is expected to aggressively introduce FDI. The rates of growth of exports of Indonesia and the Philippines were assumed to be high bearing in mind the increase in export capacity made possible by this increased flow of FDI (see Table 4). Indonesia should enjoy a 9.6 percent annual export growth from 1996 to 2000 or the same as the 1986 to 1995 period. Indonesia’s exports are expected to accelerate in growth from 2001 to 2005 to reach an annual 11.0 percent. The rate of growth of exports of the Philippines is expected as reaching an annual 17.6 percent from 1996 to 2000. This rate of growth would be about double the actual 9.8 percent of 1986 to 1995. From 2001 to 2005, exports of the Philippines are expected as growing by an annual 15.1 percent – still a high level but slower than the five years before this.

### **Growth Accelerating in Indonesia due to Stable Political Situation**

Investment in Indonesia slowed in growth in 1997 and 1998. This slowdown in investment can be said to be a technical correction to the large rise in FDI in 1995 and 1996 due to the major steps taken by the government to ease restrictions on FDI in 1994.<sup>15)</sup> Due to the decline in the growth of this

investment, Indonesia’s economic growth rate, as shown in Table 5, will fall from the 7.8 percent of 1996 to 7.5 percent in 1997 and further to 6.8 percent in 1998. It is assumed that the political situation will remain stable after the 1998 presidential elections and that the inflow of FDI will speed up. Reflecting this, starting 1999, the favorable cycle of investment and export will cause the economic growth of Indonesia to accelerate to the 10 percentile range from 2001 to 2003 as shown in Table 5. In 2004, there will be a breather in the double-digit investment growth of the previous five years. Along with the blunting of export growth, economic growth will drop 4 points to 6.4 percent. In 2005, however, investment growth will return to the double-digit level and the economic growth rate will rise to 9.0 percent

The changes in the economic growth rate and rate of inflation of Indonesia may be seen from Table 6 and Table 7. From 1996 to 2000, the average annual rate of inflation will be 6.9 percent or 1.2 points down from the annual 8.1 percent of 1986 to 1995. With these stabilizing prices, the economic growth rate will rise to an average annual 8.0 percent in 1996 to 2000 or 0.2 points up from the rate of 1986 to 1995. From 2001 to 2005, further, the rate of inflation will drop to 6.2 percent or a further 0.7 point down from the annual rate of the previous five years. Economic growth will on the other hand rise 1.4 points over the previous five years to a high average annual 9.4 percent.

If the reins of power are passed smoothly on to the next generation of leaders and the political situation otherwise remains stable, Indonesia should enjoy a high rate of economic growth on a par with China in the beginning of the 21st century.

### **Philippines Fast Catching Up**

Assuming the previously explained conditions, the rate of economic growth in the Philippines should accelerate from the 5.5 percent of 1996 and rise to 7.8 percent by the year 2005 (see Table 5). This faster pace of economic growth will be brought about by the favorable cycle of FDI and exports. According to Table 6, the average annual growth rate of the Philippines from 1996 to 2000 will be 6.7 percent or double the annual 3.4 percent for 1986 to 1996. A look at the average annual rate of inflation in Table 7 shows that inflation will be 6.9 percent in 1996 to 2000 or 3.1 points lower than the

9.0 percent of 1986 to 1995. Viewed from the dual aspects of growth and inflation, the economy of the Philippines will enter a full-scale era of growth in 1996 to 2000. The economy of the Philippines will further accelerate in growth from 2001 to 2005 to an annual 7.8 percent. The rate of inflation during the period should be an annual 6.8 percent or roughly the same as in the previous five years.

### Notes

12. "BOT" is an abbreviation for "build-operate-transfer". Under this scheme, a private company constructs a highway and etc. with its own funds and operates it for a certain time to make a profit. It then transfers ownership over to the government. "BOO" is an abbreviation for "build-operate-own". Under this scheme, a private company constructs and operates a power station and etc. It continues owning it without transferring ownership to the government.
13. There was a drop in the growth of exports in Malaysia due to the "technical adjustment" after the sharp rise in exports in the previous year.
14. Malaysia, like Singapore, is introducing a relatively large amount of both capital and labor from other countries. In Yamaji (1997), a supply oriented model similar to that of Singapore is built for Malaysia as well. According to the projection, the average annual rate of growth of labor demand in Malaysia from 1996 to 2005 will be 3.4 percent corresponding to the 7.6 percent annual growth. This is equivalent to the average annual rate of increase of employment from 1986 to 1995. As explained with relation to Singapore, assuming the government's stance toward the labor market, at least, does not change that much, the growth in labor demand and economic growth projected for 1996 to 2005 should be achievable.
15. This includes the more-than-half abolishment of the obligatory transfer by foreign ventures of equity to domestic nationals after a certain period of time. Regarding this point, see Ishida (1997).