

AEC: THE CHINA-ASEAN CONNECTION

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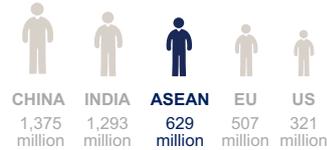
ASEAN GDP

Between 2007 and 2015, ASEAN's GDP **nearly doubled** to US\$2.5 trillion in 2015 while GDP per Capita is projected to reach **US\$5,347 by 2020**



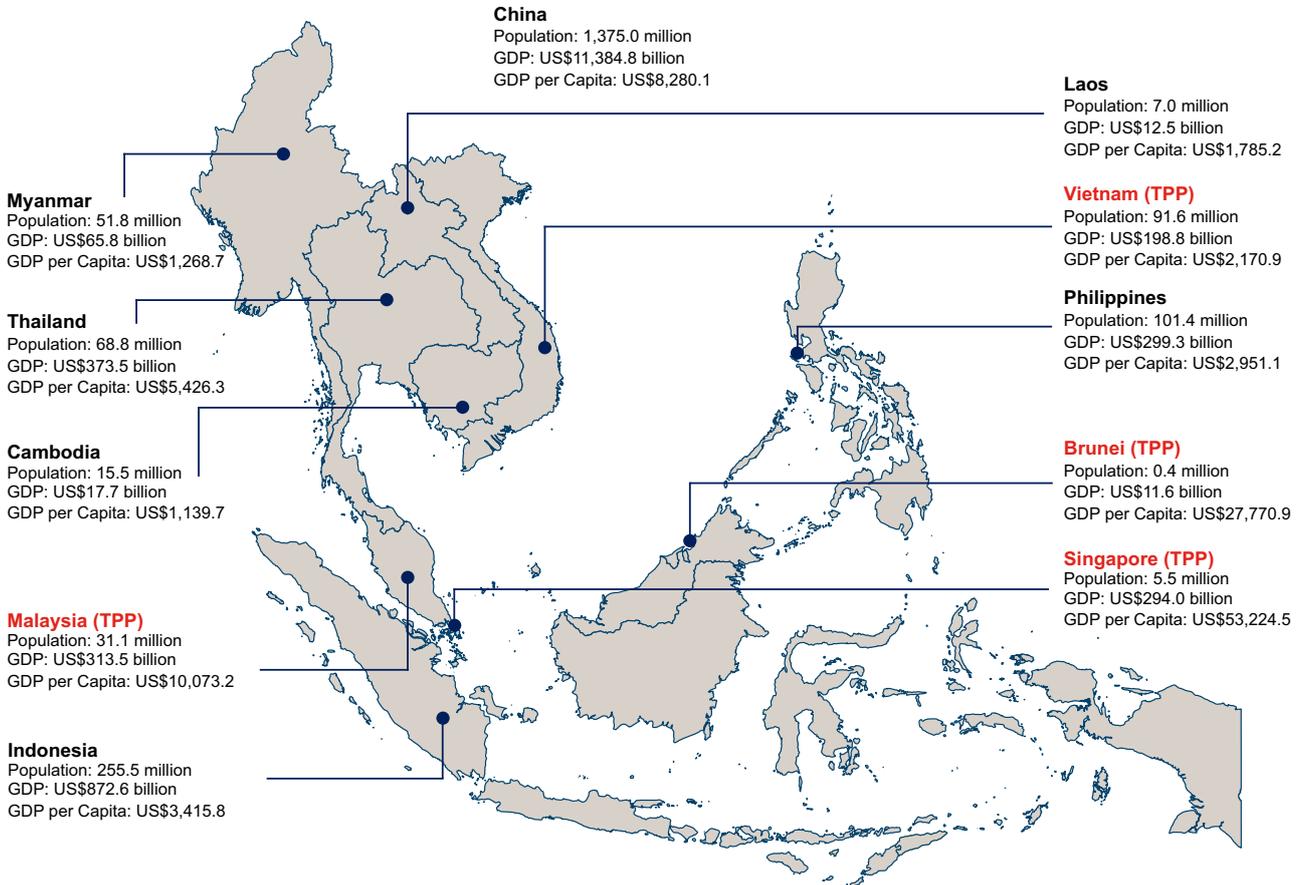
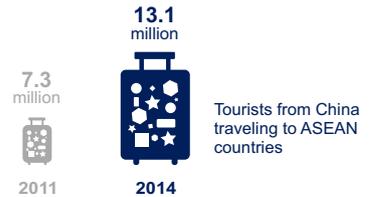
ASEAN POPULATION

In 2015, ASEAN's population was the **3rd largest in the world**



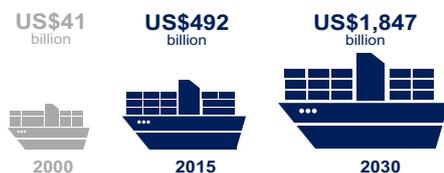
ASEAN TOURISM

Between 2011 and 2014, **Chinese visitors to ASEAN countries** had surged **79%**, compared to an increase of 25% in tourist arrivals from the rest of the world



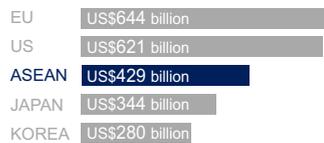
ASEAN TRADE WITH CHINA

Between 2000 and 2015, total trade between China and ASEAN had risen **10X** to **US\$492 billion** and projected to reach **US\$1,847 billion by 2030**



ASEAN TRADING PARTNERS

ASEAN is China's **3rd largest trading partner**



China is the largest trading partner for **7** of the 10 ASEAN members

ASEAN INVESTMENT

China's Overseas Direct Investment (ODI) into ASEAN economies had risen over **200%** to **US\$7.8 trillion in 2014** from US\$2.5 trillion in 2008



Source: UOB Global Economics & Markets Research, Free Vector Maps

ASEAN Focus

AEC: The China-ASEAN Connection

In the first part of this series (published in 2015 Q4 Quarterly Report), we discussed the economic potential of ASEAN in view of the implementation of the ASEAN Economic Community (AEC) at end-2015. We also highlighted the favourable demographic and income trends that will drive ASEAN economies to become one of the top economic regions for investment with its single production base and a large consumer market for global corporates. Then in the second part (published in 2016 Q1 Quarterly Report), we pointed out that the lack of infrastructure development in ASEAN today remains the biggest challenge but it also presents immense opportunities for foreign direct investment. With better infrastructure and facilities, more manufacturing activities and services can be generated and that will lead to increased trade volumes in goods and services for ASEAN members. In this third and final part of the series, we will discuss the closer integration between ASEAN and China, which is a result of several ongoing initiatives such as the One Belt, One Road, AIIB, TPP, and the AEC.

Trade is Not a Zero-Sum Game

The AEC will be crucial in facilitating the freer movement of goods and services for its 10-member countries, and thus enlarging the trading sphere of ASEAN (and generate more intra-regional trade). However, one must not have the misconception that this implies a return to the old ages of mercantilism, where ASEAN is now deemed to be a single large cartel that aims to accumulate monetary reserves through a positive trade balance, and the concept that trade is a zero-sum game is worshiped.

In fact, there are more worries that the AEC could potentially cannibalize trade/investment flows to another nearby, competing economy such as China. We suggest for such worries to be put aside. Since the time when the benefits of free trade were posited by Adam Smith and David Ricardo, economists has mostly come to accept that trade is not a zero-sum game, but can be a win-win situation. That is, since the stages of economic development and factor endowments

are different between China and the 10 ASEAN countries, there are more reasons for the economies to increase trade/investment between one another.

Even before the AEC was mooted, China has been playing an active role in building trade and investment relations with ASEAN in the past decade, extending the historic relationship that dates back to thousands of years.

To illustrate the very close relationship and interdependence, China today is the largest trading partner for 7 out of 10 ASEAN members; while ASEAN as a region is China's 3rd largest trading partner. Since China's ascension into the WTO in 2001, ASEAN's total trade with China had increased 10-fold and this had benefitted millions of people in both regions due to jobs creation, higher incomes and better living standards.

In 2013, China's President Xi Jinping mooted the idea of the New Silk Road, or the Maritime Silk Road that starts from Fujian province and linking all the littoral countries of the region. This Maritime Silk Road concept will even further deepen China's connection with ASEAN, with the AEC serving as a major catalyst.

From China's perspective, reaching out to ASEAN and other regional countries is

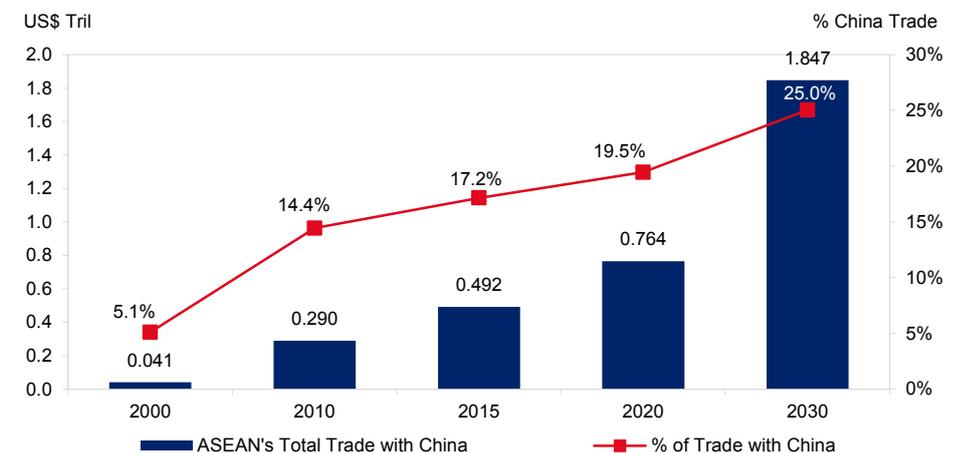
not a want, but a need. As China faces its domestic "growing pains" of rising labour costs, land costs, and slowing economic growth, it is increasingly seeking new production and market bases overseas. ASEAN is a natural destination given the geographic and historic ties. In fact, several new initiatives such as the upgrading of the ASEAN-China FTA, the setting up of the Asian Infrastructure Investment Bank (AIIB), and the mooted of the One-Belt, One-Road (OBOR) strategy will further promote cooperation between both regions.

Nothing could be more telling about the strong economic ties between China and ASEAN than a quick look at how trade between the two had grown over the years. [Exhibit 1](#) shows that total trade between China and ASEAN had risen 10-fold from US\$41 billion in 2000 to US\$492 billion in 2015 (estimated). As a share of ASEAN's total trade with the world, China had accounted for 5.1% in 2000 and this had more than tripled to 17.2% in 2015. Based on our projections, China's share of ASEAN's total trade could reach 25%, or US\$1.85 trillion, by 2030.

On the investment front, China's push in recent years to investment overseas (in order to balance out investment inflows and also partly to reduce appreciation pressure on the RMB), have seen ASEAN as a main beneficiary. China's overseas direct investment (ODI) to the world-ex Hong Kong had been growing very strongly at 37% p.a. from 2003 to 2014. During this period, Asia had been the number two region for China's overseas investment (ex-HK), averaging 22% of

EXHIBIT 1: Rising Trade Between China And ASEAN

Source: IMF, UOB Global Economics & Markets Research Estimate



total ODI to the world. In 2014, the share of ODI to Asia (ex-HK) was 27%, at US\$14.1 billion ([Exhibit 2](#)).

Of China's US\$14.1 billion ODI into Asia (ex-HK) in 2014, 55% was directed into ASEAN economies, at US\$7.8 billion. In fact, over the 2003-14 period, ASEAN had accounted around 48% of ODI into Asia (ex-HK) on average, thereby highlighting the opportunities and importance of ASEAN to Chinese corporates and investors.

A breakdown of the ODI into ASEAN ([Exhibit 3](#)) shows that the largest chunks traditionally came into Singapore (at 33% on average during 2003-2014), Indonesia (15%), Thailand (11%), and Laos (9%).

Even Closer ASEAN-China Economic Ties: Not A Want, But A Need

In the years ahead, we postulate that there will be an even greater degree of intra-ASEAN trade, as well as ASEAN-China trade. The key reason is due to the structural shift in China's demographic trend which will result in a shift in the existing industry mix, where less efficient/productive operations will move out and situate in selected ASEAN countries.

As of 2015, it is estimated that 9% of the Chinese population (132 million pax) is above the age of 65 years old (and thus assumed not to be economically active). By 2030, it will be 14% (235 million pax). In fact, China's population is estimated to start shrinking from 2031, while ASEAN's population is estimated to reach a maximum of nearly 800 million pax before shrinking from 2064 ([Exhibit 4](#)).

With China's population greying rapidly, future economic growth strategies will be concentrated in capital-intensive, high labour-productivity manufacturing as well as services industries. Lower-value added manufacturing activities will move out of China as the higher labour costs no longer justifies the production of such goods. As such, trade flows in goods/services between China and ASEAN countries will only increase further as the former outsources the labour-intensive and lower-value added activities.

Even within the manufacturing sector, firms in China will move up the value chain towards having a higher ratio of manufacturing 'services' in their total

EXHIBIT 2: Share Of China's ODI (ex-HK) To The World

Source: CEIC, UOB Global Economics & Markets Research Estimate

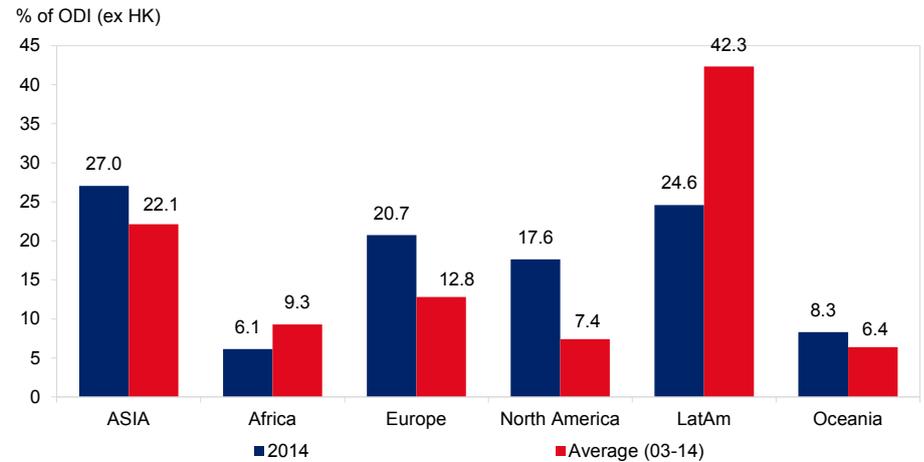


EXHIBIT 3: China's ODI To ASEAN Economies

Source: CEIC, UOB Global Economics & Markets Research Estimate

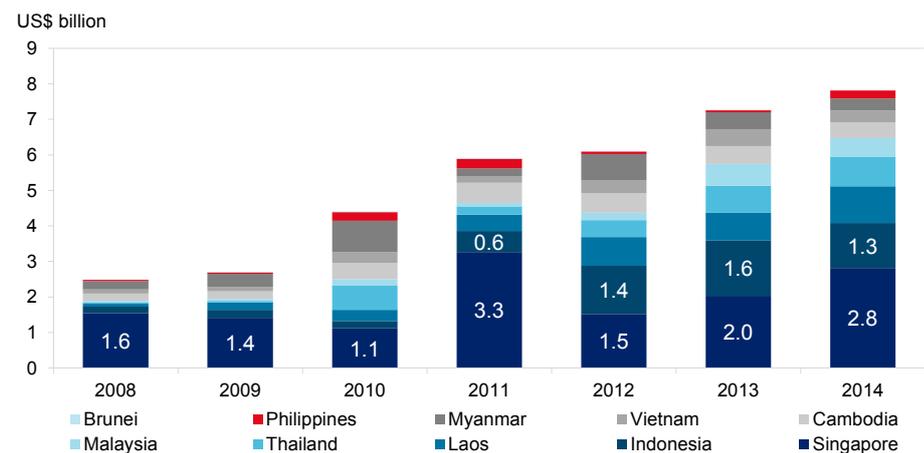
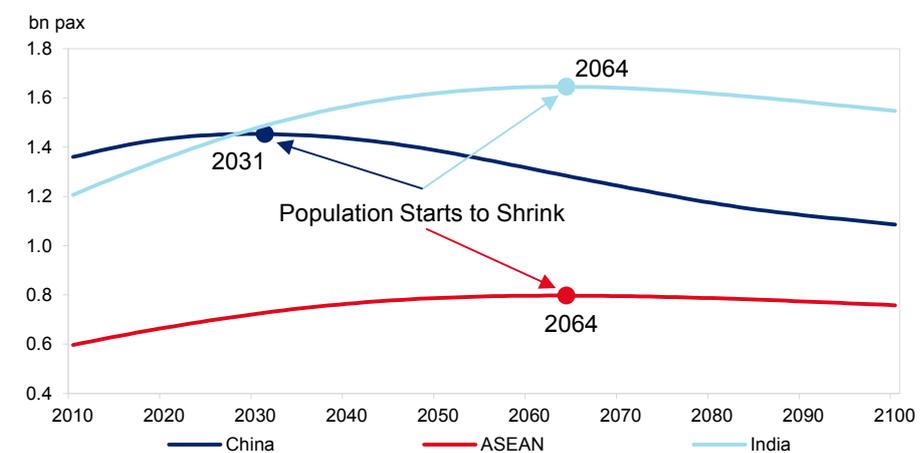


EXHIBIT 4: China's Population To Start Shrinking In 2031

Source: World Population Prospects 2014, UOB Global Economics & Markets Research Estimate



output as they try to shed off labour-intensive production (where value-added per unit produced is lowest). This is where emerging ASEAN economies can potentially enter to fill the manufacturing vacuum ([Exhibit 5](#)).

Conclusion

In conclusion, the economic opportunities from the economic agglomeration of ASEAN nations will be immense. The rise of China, coupled with the establishment of the AEC from -2016 onwards, is expected to provide new catalysts for growth in ASEAN. Even with the use of fairly conservative assumptions in our economic projections (i.e. in most of forecasts in this report, we assumed just half of the compounded growth rates seen in the previous period), the future of ASEAN is indeed promising.

Domestic factors such as population growth, rural-urban migration and the rise in the middle income class in ASEAN will pave the way for AEC's promise of an integrated production platform and an enlarged consumption base. The resultant trade, financial, and social integration will be beneficial to trade, tourism and investment in the region.

At the same time, the shift in domestic conditions in China is propelling an outward orientation mindset. Initiatives such as the AEC will be complementary to and further enhanced by other programs such as the AIIB, Maritime Silk Road, and the upgrading of the ASEAN-China FTA.

EXHIBIT 5: Emerging ASEAN Economies Can Fill The Manufacturing Vacuum

Source: Stan Shih, Former Chairman of Acer Group, 1992

