ASEAN Connect
By Global Economics & Markets Research

ASEAN: FDI inflows declined in 2020 but RCEP to be the next impetus

Summary

Global foreign direct investment (FDI) flows declined by 42% in 2020 with ASEAN recording a more moderate fall of 31%. China became the top FDI destination after its decisive handling of the pandemic and early economic recovery, while the US fell to second position.

UNCTAD has warned that FDI is expected to remain weak in 2021, although historically ASEAN has generally outperformed in the competition for FDI inflows, due to stability in the region, and an openness to foreign investments. The addition of RCEP will be another catalyst for ASEAN's prospects ahead.

RCEP countries have been the leading destinations for global FDI inflows in recent years, and this position is likely to be entrenched further once the FTA goes into force. In addition, the region's global value chain (GVC) participation, China's dual circulation strategy and ASEAN's rising population and income will also be the main drivers for further investments into the region.

FDI into ASEAN fell sharply in 2020 amidst global pandemic

Latest data released by UNCTAD (United Nations Conference on Trade and Development)[1] showed that foreign direct investment (FDI) inflows into ASEAN declined 31% to USD107 billion in 2020.

However, the drop in ASEAN was relatively less severe than the global FDI flows which fell 42% during the year, as the COVID-19 pandemic impacted all types of investment channels: greenfield investment projects, cross-border M&As, and international finance project deals.

Notably, FDI inflows to China rose 4% to USD163 billion in 2020, along with an increase of inflows into Hong Kong SAR as well, despite the twin impact from the aftermath of the 2019 unrest and the global COVID-19 pandemic faced by the city.

China thus became the top destination of FDI inflows in 2020, with the US trailing in second position after a 49% drop in inflows. This was followed in third place by the European Union, which saw an outsized 71% decline in FDI inflows.

The fall in investments to the US was attributed to significant declines from the UK, Germany and Japan, in wholesale trade, financial services, and manufacturing, along with a 41% drop in cross-border M&A sales of US assets to foreign investors, particularly in the primary sector.

[1] Investment Trends Monitor, 24 Jan 2021, UNCTAD https://unctad.org/system/files/official-document/diaeiainf2021d1_en.pdf

As for China, its effective and decisive handling of the COVID-19 pandemic, subsequent relaxation of lockdowns and normalization of activities, and speedy economic rebound have supported investor confidence and provided favourable conditions for investments to return to the country.

Indeed, China's economic activities rebounded sharply and daily life largely resumed normalcy after hitting a trough in 1Q20, with the country registering 2.3% GDP growth in 2020 and becoming the only G20 economy to register an economic expansion during the year (For more details, please refer to China: Economy Sustains Recovery Momentum In 4Q20, 18 Jan 2021). UNCTAD noted that cross-border M&As in China rose 54% during the year, mostly in tech and pharmaceutical industries.

Top Foreign Direct Investment (FDI), inflows destinations

Source: Macrobond, UOB Global Economics & Markets Research

UNCTAD Last: 25 Jan 202	Annual, USD, trillion 0.0 0.3 0.6 0.9 1.2	2020	y/y % chg 2020	2019	CAGR % 2009-19	2009
World		859 billion	-42.5	1.5 trillion	1.9	1.24 trillion
China		163 billion	4.0	157 billion	5.2	94.1 billion
United States		134 billion	-49.0	263 billion	6.2	144 billion
European Union		110 billion	-70.5	373 billion	0.3	362 billion
ASEAN		107 billion	-31.3	156 billion	14.2	41.4 billion
Hong Kong		95.7 billion	40.0	68.4 billion	2.1	55.5 billion
Singapore		58 billion	-37.0	92.1 billion	17.4	18.5 billion
India		57 billion	12.8	50.6 billion	3.6	35.6 billion
Brazil		33 billion	-54.2	72 billion	10.7	25.9 billion
Canada		32 billion	-36.4	50.3 billion	8.3	22.7 billion
Mexico		31 billion	-5.8	32.9 billion	6.3	17.9 billion
Sweden		29 billion	141.7	12 billion	1.7	10.1 billion
Germany		23 billion	-36.7	36.4 billion	4.3	23.8 billion
Australia		22 billion	-46.0	40.7 billion	2.5	31.9 billion
France		21 billion	-38.2	34 billion	1.0	30.7 billion
Indonesia		18 billion	-24.0	23.7 billion	17.1	4.88 billion
Japan		17 billion	16.8	14.6 billion	2.0	11.9 billion
Vietnam		14 billion	-10.0	15.6 billion	7.4	7.6 billion
Turkey		6.8 billion	-19.4	8.43 billion	-0.2	8.59 billion
Philippines		6.4 billion	29.0	4.96 billion	9.6	1.99 billion
South Korea		6.13 billion	-42.0	10.6 billion	1.6	9.02 billion
Saudi Arabia		4.7 billion	3.0	4.56 billion	-18.8	36.5 billion
Malaysia		2.5 billion	-68.0	7.81 billion	18.3	1.45 billion
South Africa		2.5 billion	-45.9	4.62 billion	-4.7	7.5 billion
Thailand		1.5 billion	-50.0	3 billion	-5.6	5.36 billion

Differing performances among ASEAN members

Within the ASEAN region, performances among the members were uneven in 2020 as the COVID-19 pandemic spread globally during the year. The Philippines, Vietnam and Indonesia performed relatively better than their major peers, while Malaysia and Thailand experienced sharp declines in FDI inflows.

Philippines

Philippines was the lone exception within ASEAN, with a positive 29% growth in FDI inflows in 2020, despite the weight of COVID-19 infections, as the country reported its worst GDP recession on record and the worst performance among major ASEAN economies (for more details, please refer to: Philippines: 2020 Posted The Worst Full-Year GDP Contraction On Record, 28 Jan 2021).

Vietnam

FDI inflows to Vietnam declined at a more moderate pace compared to its ASEAN neighbours as the country was able to control COVID-19 pandemic for most of 2020. As a result economic activities expanded 2.9% during the year, one of the few Asian economies that were able to accomplish such feat, with a sharp growth rebound expected in 2021 (for more details, please refer to: Vietnam: Economic Growth Recovers Further In 4Q, Fuels Optimism For 2021, 6 Jan 2021). In addition, relocation of supply chains and infrastructure investments continued during the year also helped sustained FDI inflows.

Indonesia

Indonesia also saw relatively outperformance against its peers during the year, with inflows falling a relatively mild 24%, to USD18 billion. The outlook for FDI inflows ahead looks promising as the country managed to achieve its overall investment targets in 2020 (For more details, please refer to: Indonesia Reached The Direct Investment Target By End-2020, 25 Jan 2021). The recently passed Omnibus Law could potentially elevate Indonesia's cost competitiveness and efficiency (For more details, please refer to: Indonesia Focus: Opportunities And Challenges Of Indonesia's Omnibus Law, 1Q21).

Malaysia

Malaysia experienced the worst decline in FDI inflows within ASEAN in 2020, partly hurt by both ongoing political uncertainty and movement restrictions in response to the COVID-19 pandemic through the year, delaying some investment decisions. However, with investment approvals in the first 9 months of 2020 exceeding MYR100 billion, particularly with strong gains in investment approvals in the manufacturing sector (+16.6% y/y), the actualisation of these approvals should pave the way for further inflows in 2021 and beyond (For details, please refer to: Malaysia: Approved Investments Exceed MYR100bn In Jan-Sep, 11 Dec 2020).

Thailand

Thailand was the second worst performer in terms of FDI inflows in 2020 within the ASEAN bloc, which UNCTAD attributed to a divestment of a foreign-owned supermarket chain to a Thai investor group during the year. Historically Thailand's FDI performance has lagged its peers by a wide margin (CAGR of -5.6% vs. 14.2% for overall ASEAN), and outlook for Thailand could be challenging as competition for investment is likely to remain fierce in the years ahead.

Singapore

As a regional and financial hub, Singapore has traditionally enjoyed large FDI inflows compared to other ASEAN members. Nevertheless, COVID-19 pandemic and a slump in business activities globally saw FDI inflows to Singapore contracting by 37% to USD58 billion, worse than the overall decline of 31% for ASEAN. This is largely due to an 86% plunge in cross-border M&As as foreign acquisitions slowed in the region, according to UNCTAD. Nevertheless, the outlook for Singapore's FDI inflows remains positive, as regional economies are expected to see a growth rebound in 2021, which would be favourable to Singapore's role as an investment funnel to the region. Within Singapore, there are other positive factors that will attract investment inflows in the years ahead, such as an open economy, external connectivity, and business continuity, among others. Singapore managed to attract SGD17.2 billion (USD12.7 billion) in fixed asset investments in 2020 – the largest amount since 2008 and well above the official mid- to long-term target of SGD8-10 billion – despite weathering its worst recession since independence. Furthermore, Singapore has targeted to grow its manufacturing sector by 50% over the next 10 years as it works to ensure that the sector continues to contribute to about 20% of economic output over the medium term. The signing of RCEP (Regional Comprehensive Economic Partnership) will be another catalyst just as companies relocate and reconfigure supply chains in a post-pandemic world.

ASEAN: Foreign Direct Investment (FDI), annual inflows, 2020

Source: Macrobond, UOB Global Economics & Markets Research

UNCTAD Last: 25 Jan 2021	USD, billion (0 20 40 60 80 100)	2020	y/y % chg 2019-2020	2019	CAGR 2009-19	2009
ASEAN		107 billion	-31.3	156 billion	14.2	41 billion
Singapore		58 billion	-37.0	92 billion	17.4	19 billion
Indonesia		18 billion	-24.0	24 billion	17.1	4.9 billion
Vietnam		14 billion	-10.0	16 billion	7.4	7.6 billion
Malaysia		2.5 billion	-68.0	7.8 billion	18.3	1.5 billion
Philippines		6.4 billion	29.0	5 billion	9.6	2 billion
Cambodia		n/a	0.0	3.7 billion	14.2	985 million
Thailand		1.5 billion	-50.0	3 billion	-5.6	5.4 billion
Burma (Myanmar)		n/a	0.0	2.8 billion	58.8	27 million
Laos		n/a	0.0	557 million	11.4	190 million
Brunei		n/a	0.0	275 million	-2.9	370 million

■ 2020 ▲ 2009

While performances differed among the members, overall for ASEAN, the setback from the COVID-19 pandemic and slump in the global economy has resulted in a relatively more moderate impact on investment inflows (-31%), compared to the world (-42%). UNCTAD has warned that FDI is expected to remain weak in 2021 (forecast: -5% to -10%), and with forward indicators pointing to continued downward pressure.

Nevertheless, historically ASEAN and its members have generally outperformed in the competition for FDI inflows, with a compound annual growth rate (CAGR) of 14% over the 2009-19 period, far ahead of the 5.2% pace for China and 6.2% for the US. This is largely due to the stability in the region, and an openness to foreign investments. Meanwhile, the addition of RCEP will be another catalyst for ASEAN's prospects ahead.

RCEP: key catalyst for further FDI inflows into ASEAN

After 8 years of negotiations, the Regional Comprehensive Economic Partnership (RCEP)[2] free trade agreement (FTA) was signed in November 2020. This agreement will be one of the key growth drivers for the 15-member FTA in the coming decades as the regional bloc will be increasingly more economically integrated.

RCEP is the world's largest FTA, covering 30% of the world's GDP and world's population, and 27% of the world's total trade (i.e. merchandise exports and imports) value in 2019. Furthermore, RCEP members produced nearly half of the world's manufacturing output. (For more details, please refer to [Asia: RCEP To Drive Further Economic Cooperation](), 16 Nov 2020; link to [Chinese version]()).

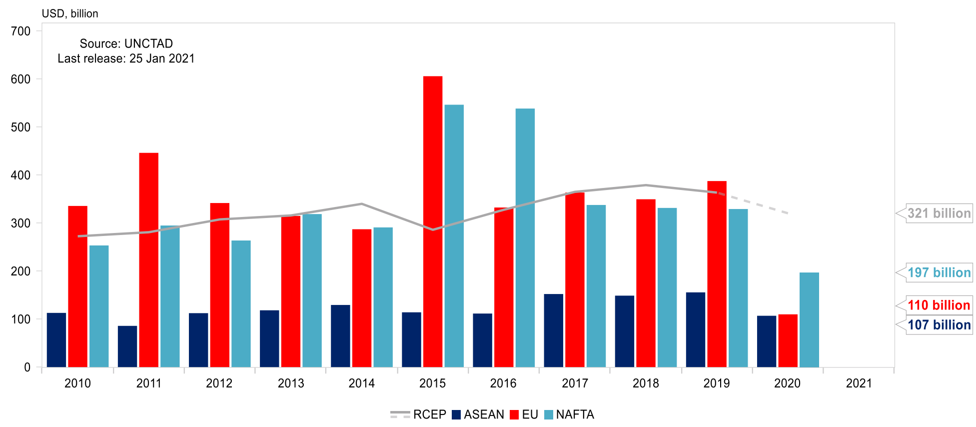
There are several factors that will be attractive to investors looking to deploy their FDI flows into RCEP:

1) RCEP's adoption of a harmonised Rules of Origin (ROO) will allow ample opportunities for the shifting and diversification of supply chains within RCEP, especially in light of the COVID-19 pandemic and uncertainty in US-China relationship. Additionally, it is also attractive for non-RCEP/third country companies looking to produce and export to RCEP members, especially to the rising ASEAN market as well as China, which is adopting a "dual circulation" economic strategy and projecting to double the size of its economy by 2035 (For more details, please refer to: [China: 14th 5-Year Plan (2021-2025) and Long-Range Objectives Through the Year 2035](), 4 Nov 2020; link to [Chinese version]()).

2) In terms of FDI inflows, RCEP as a grouping has been a main investment destination in recent years, due to the size of its economy, as well as a highly diverse range of countries with varied degree of economic development, cost structures and resource endowments. FDI inflows into RCEP accounted for 37% share of global FDI inflows in 2020, an increase of nearly 12% points from 2019, and well ahead of another more established grouping, NAFTA (now called USMCA or United States-Mexico-Canada Agreement on trade). On the other hand, the share European Union (EU) in FDI inflows has fallen steadily through the years, from 29% in 2009 to 13% in 2020.

UNCTAD Foreign Direct Investment (FDI), inflows, annual

Source: Macrobond, UOB Global Economics & Markets Research



[2] RCEP consists of 15 members: all the 10 member states in ASEAN, China, Japan, South Korea, Australia and New Zealand.

Foreign Direct Investment, Inward Flows, % Share

Source: Macrobond, UOB Global Economics & Markets Research

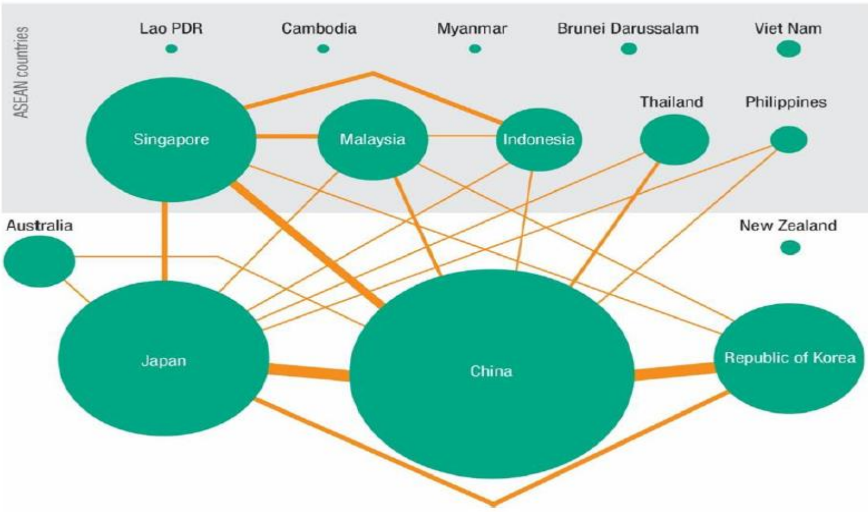
UNCTAD Last: 25 Jan 2021	% share of total 0 10 20 30	2020	% pt chg 2019-2020	2019	% pt chg 2009-19	2009
RCEP		37.3	13.7	23.6	8.3	15.3
NAFTA		22.9	1.5	21.4	6.5	14.9
European Union		12.8	-12.4	25.2	-4.1	29.3
ASEAN		12.5	2.3	10.1	6.8	3.4
South Asia		7.6	3.8	3.7	0.3	3.4
South America		7.0	-0.6	7.6	2.8	4.9
Africa		4.4	1.5	2.9	-1.6	4.6

■ 2020 ▲ 2009

3) RCEP is highly integrated into the global value chains (GVC), accounting for 26% of the world's GVC trade volume (in both trade in goods and services), according to the United Nations. In addition, intra-regional value chain trade within RCEP has grown even faster, rising 50% over the 2010 level to US$1.7 trillion in 2017. However, as shown in the chart, GVC in RCEP is centered on large and established hubs such as China, Japan, and South Korea, giving room for trade and investment opportunities for peripheral countries such as Vietnam and Myanmar.

Value chain connections within RCEP

Source: Global Investment Trend Monitor, No. 37, p4



Source: UNCTAD, based on the UNCTAD-Eora database, 2019.
Notes: The size of spheres represents the share of intra-RCEP value chain trade. The thickness of the lines depicts the volume of value chain trade. Only trade volumes above $10 billion are included.

The UN study also noted that GVC patterns are closely connected to FDI patterns, with the top 5 GVC industries in RCEP absorbing more than 50% of the value of greenfield investment project announcements. In RCEP, the GVC is dominated by 5 industries, namely electrical and machinery, petroleum and chemicals, metal, textile and apparel, and transport equipment. These industries collectively account for 60% of total RCEP's GVC trade.

With RCEP the leading destination for global FDI inflows in recent years, this position is likely to be entrenched further once the FTA goes into force (currently awaiting ratification by various governments). In addition, the region's deep-rooted GVC participation, China's dual circulation strategy, and ASEAN's rising population and income will also be the main drivers for further investments into the region and ASEAN.

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