News Release

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Southeast Asia set to benefit from China's economic rebalancing

Foreign investment pouring into China is going through a seismic shift from low-end manufacturing towards services. This is shaking up the global supply chain status quo, and thrusting fast-growing but still relatively low-cost Southeast Asia into the spotlight as an attractive alternative location for labour-intensive manufacturing.

As China's economy has developed and grown, wages and production costs have risen sharply. Manufacturing goods in China is no longer as cheap as it once was. Markets such as Vietnam and Cambodia are becoming appealing alternatives for foreign companies that are mulling investments in labour-intensive manufacturing projects.

The shift in Foreign Direct Investment (FDI) flows towards value-added sectors such as services and high-tech manufacturing is in line with government efforts to maintain strong economic growth and draw greater attention from overseas investors. Beijing recently launched the "Made in China 2025" initiative, which outlines a ten-year plan to move higher up the value-added chain.

The numbers already show the changes at work. China attracted USD 85.34 billion in FDI in the first eight months of this year, up 9.2 per cent from a year earlier. Investment into services and high-tech services grew particularly quickly. This is an indication that foreign investors are taking advantage of the broad rebalancing of the world's second-largest economy; they are also choosing to invest in China in a bid to access the country's abundant and increasingly wealthy consumer base.

All of this has big implications for Southeast Asia. As China evolves, this region is set to benefit, by becoming an alternative destination of choice for companies as they seek bases for their labour-intensive manufacturing activities.

Southeast Asia's biggest advantages are simple: Labour costs in much of the region are low; and it is within striking distance of China. Manufacturers setting up operations in Southeast Asia get the best of both worlds: they can reduce production costs, while at the same time continuing to serve China's well-established supply chain infrastructure and its 1.4 billion consumers.[1]

We have already seen a growing number of international companies diversifying their manufacturing chains. A classic pattern is this: manufacture parts and components in cost-effective locations like Vietnam or Cambodia; conduct final assembly in China; and sell the end-product either to China's new consumers or to traditional markets in Europe and the United States.

In addition, Southeast Asia – which spans countries as diverse as Thailand, Laos and Indonesia -- has its own, promising growth dynamics, which will see it attract a growing slice of the global FDI pie in coming years.

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[1] http://www.businessinsider.com/afp-chinese-dragon-losing-its-shine-for-foreign-firms-2015-8

The Asian Development Bank expects the region as a whole to grow 4.6 per cent this year[2] . That is significantly faster than both the United States (2.4 per cent, according to HSBC's latest forecasts) and the Eurozone (1.5 per cent). Malaysia's economy is expected to expand 4.6 per cent.[3]

The region has a growing capacity for handling sophisticated production of an expanding scale. But it currently accounts for almost 4 per cent of global manufacturing in value-added terms – leaving lots of room for growth.[4]

Finally, much of Southeast Asia is about to undergo a burst of far-reaching economic integration. At the end of this year the ten members of the Association of Southeast Asian Nations (ASEAN) will form the ASEAN Economic Community (AEC). This will help free up the flow of goods, services, investments and skilled labour, and the freer movement of capital across the entire region.

"As the Chair of ASEAN for 2015, Malaysia is playing a key role in the formal implementation of the AEC. With the ASEAN region becoming more connected, Malaysia can utilise its Chairmanship role to become the gateway to ASEAN. One of the key priorities for Malaysia will also be to develop Malaysia as a key business hub and to further increase ASEAN's contribution to the global economic growth," said Mukhtar Hussain, Deputy Chairman & Chief Executive Officer, HSBC Bank Malaysia Berhad.

Malaysia is at the centre of Southeast Asia and has developed infrastructure and transport links with 600 million people[5]. The synergies and economies of scale made possible by the AEC, and the region's large and increasingly affluent consumer base, have the potential to turn Southeast Asia into a global economic powerhouse.

"It is also interesting to note that more Chinese investors are tapping into the Malaysian market. Chinese entrepreneurs can use Malaysia as the gateway to the AEC, and explore business opportunities that can benefit both sides," Mukhtar added.

In fact, in a recent visit to Penang, the Chinese Ambassador to Malaysia, Dr Huang Huikang, said he was actively promoting Penang to Chinese businesses. According to Dr Huang, a Chinese consul-general office will also be operational in Penang by the end of the year to facilitate visa requirements for Perak, Penang, Kedah and Perlis. Additionally, Air China has resumed direct flights between Beijing and Kuala Lumpur since 25 October, while Malindo Air will start a Kuala Lumpur-Penang-Hainan route next month.

It seems likely that no single Southeast Asian country will be the solitary beneficiary of any large industrial relocation from China. Much will depend on the exact requirements of the production facilities being located there, as well as the perceived ease of doing business in any particular country.

[2] Asian Development Bank forecasts, as per July 2015 http://www.adb.org/publications/asian-development-outlook-supplement-july-2015
[3] HSBC Global Economics Quarterly, September 2015: https://www.research.hsbc.com/midas/Res/RDV?key=fCpTfsVDL4&n=478926.PDF
[4] http://blog.frontierstrategygroup.com/2014/04/what-does-the-rise-of-manufacturing-in-asean-mean-for-multinationals/
[5] http://www.google.com.hk/url?sa=t&rct=j&q=&esrc=s&source=web&cd=3&ved=0CCgQFjACahUKEwipwqOQ9J_HAhXEKpQKHeC5CmU&url=http%3A%2F%2Fwww.mckinsey.com%2Finsights%2Fpublic_sector%2Funderstanding_asean_seven_things_you_need_to_know&ei=vVPJVenvKMTV0ATg86qoBg&usg=AFQjCNEVVQIKHY42SGDRmOLw3rikysPasQ&sig2=lhTGrlXYH0nGzyrzp6EwRg&bvm=bv.99804247,d.dGo

Infrastructure capabilities will also be key to realising individual countries' potential. A lot is now happening on that front – and a major impetus will come from the "One Belt, One Road" initiative, under which Beijing plans to plough billions of dollars into infrastructure projects stretching from coastal China to Central Asia, the Middle East and on to Europe.

The goal is to oil the wheels of trade – and nearby Southeast Asia will be a major beneficiary. Before too long, for example, rail networks and modern roads will link the southern Chinese province of Yunnan to the Indian Ocean via Thailand and Myanmar. This will significantly improve freight logistics and could create substantial opportunities for the development of major ports and free trade zones in Thailand and Myanmar, boosting their economic development.

"Bolstered by some of the "One Belt, One Road" projects, which will be a major catalyst for driving manufacturing and construction-related services and investment into Malaysia, trade between Malaysia and China is expected to grow to USD160 billion by 2017," concluded Mukhtar. As China moves up the value chain, Southeast Asia can step in and leverage its low-cost advantages – much like China did 20-30 years ago. The result, overall, is likely to be positive mutually beneficial for both geographies.

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