Asia Business Council

Asia Business Council Annual Survey 2019

EXECUTIVE SUMMARY

August 2019

SURVEY OVERVIEW

- Survey was conducted in July 2019
- Response rate of 76% (58 out of 76 members)
- Members were asked about their economic outlook, investment plans, and views on the U.S.-China trade conflict
- Members were also asked to consider the following issue areas:
  - Energy and the environment
  - Finance and business
  - Geo-political
  - Social
  - Technological

BUSINESS OPTIMISM PLUNGES TO A LOW NOT SEEN SINCE 2008 GLOBAL FINANCIAL CRISIS

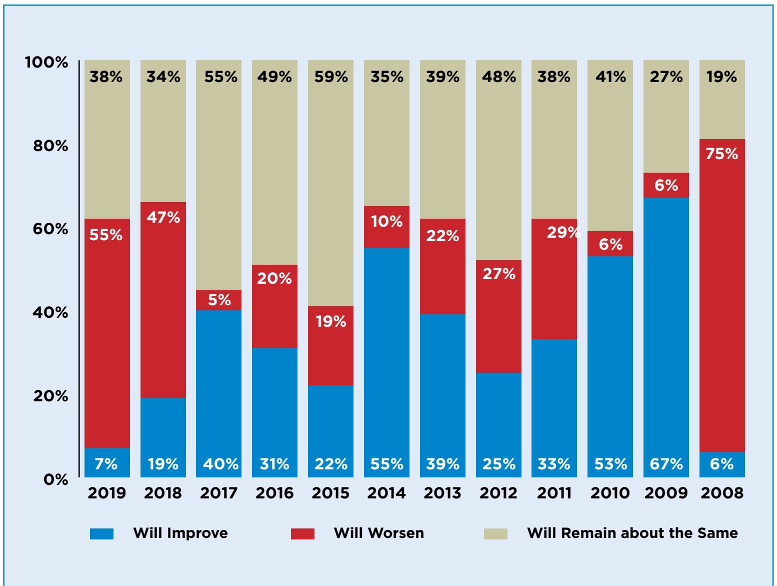

FIGURE 1
HOW DO YOU FEEL ABOUT OVERALL BUSINESS CONDITIONS IN THE NEXT 12 MONTHS?

Gloomy, if not gloomier, sums up Asia Business Council members' outlook for the coming year. More than half (55%) of the members who responded to the annual survey believed that business conditions will worsen in the next 12 months. Only 7% expect conditions to improve (see Figure 1). This is the highest level of pessimism and lowest level of optimism registered by the Council's survey since the global financial crisis in 2008. The overwhelming reason cited was the uncertainty over the trade and technological conflict between the United States and China, which respondents believed would disrupt global supply chains, hurt business sentiment, and dampen the growth of major economies. Other reasons included concerns about trade war-induced recession, Japan-South Korea trade disputes, and the impact of geopolitical conflict in the Gulf region on oil prices. Trade tensions and conflicts were regarded by more than half of respondents as the biggest economic problem for Asia.

A minority (38%) of respondents believed that business conditions would remain about the same in the coming 12 months. Those who do not expect the situation to worsen cited positive factors that help counterbalance the negative impacts of the trade conflict: Asia's relatively strong economic fundamentals; low interest rate environment that favors business borrowing; efforts that promote free trade agreements such as the proposed Regional Comprehensive Economic Partnership (RCEP); and China's Belt and Road Initiative that is driving infrastructure investment in the region.

U.S.-CHINA TRADE CONFLICT 'FUNDAMENTALLY RESHAPING THE REGION'

The majority of respondents viewed the impact of the U.S.-China trade conflict on Asian business to be negative. Some 70% of respondents said the trade conflict already had affected their business negatively (see Figure 2). Companies in technology and export-oriented sectors were particularly concerned about further tariff increases – this fear has been realized since the time of the survey. Businesses with China exposure are affected owing to waning Chinese consumption and the deteriorating investment climate. Those who saw no impact (16%) focused on serving domestic markets or believed that the full effects of the trade conflict would take some time to unfold. "It's early days," said one respondent. There were some beneficiaries of the trade conflict however, with 14% seeing a small positive impact. Some Southeast and South Asian economies such as Vietnam and India were expected to benefit from a shift in production away from tariff-hit China, with one respondent saying that China's challenge is another country's opportunity.

The U.S.-China trade conflict has also led members to rethink their investment destinations, especially China. Nearly half have considered taking concrete actions to hedge the risks of the trade conflict, for example by pausing investments and/ or decoupling supply chains. More respondents have considered postponing investment in China (17%) than in the U.S. (5%). The trade conflict has also caused some to accelerate their plans of moving capacity from China to other parts of Asia, a trend that had been emerging in the past several years due to rising labor costs in China. Almost one-fifth (19%) have thought of shifting operations or sourcing components outside China, compared with 5% who planned to do so outside the U.S. More than a third of the respondents have also explored other actions (38%), from forming joint ventures with Chinese companies to expand overseas to investing in Europe and Southeast Asia. Respondents from Indonesia, the Philippines, and Taiwan have considered re-routing part of their supply chains back home. This growing trend of on-shoring shows

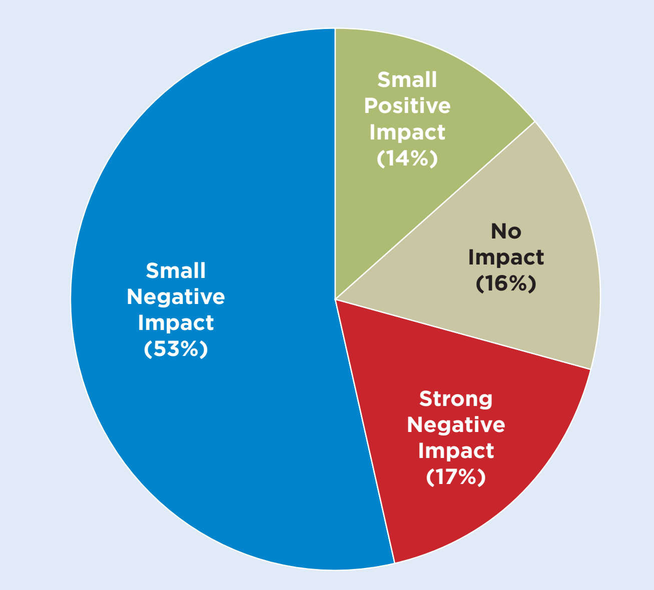

FIGURE 2
WHAT HAS BEEN THE IMPACT OF THE U.S.-CHINA TRADE CONFLICT ON YOUR BUSINESS?

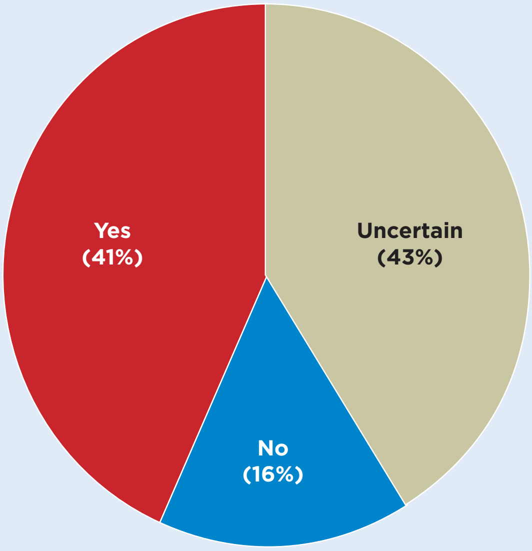

FIGURE 3
DO YOU EXPECT U.S.-CHINA TRADE TENSIONS TO WORSEN?

that rising protectionism has prompted companies to shy away from global markets to avoid tariffs.

Asked about the future development of U.S.-China trade, 43% were uncertain (see Figure 3). A sizable 41% believed that trade tensions would worsen and just 16% said they would not get worse. One respondent wrote: "Unfortunately, there is no real capacity to predict how [the trade conflict] unfolds. But it is fundamentally reshaping the region." Another respondent pointed out that while a temporary trade agreement may be reached between the U.S. and China, "the underlying contest for technological, military and economic supremacy will continue."

CHINA LOSES TO THE U.S. AS TOP INVESTMENT DESTINATION; INTEREST IN VIETNAM, INDIA GROWS

Members' appetite for overseas investment has cooled amid uncertainty over global growth and the U.S.-China trade conflict. Their reported investments in most countries (excluding their home countries) have dwindled or stagnated. China and the U.S., while still popular, have both fallen somewhat out of favor. Although the U.S. overtook China as the most favored investment destination in the last 12 months, the share of respondents having invested or raised investment in the U.S. shrank from 39% to 33% (see Figure 4). Erratic U.S. policies and slower growth prospect have reduced investors' interest in the U.S. China ranked second, with 31% of respondents investing, but its share of investment plunged by 18 percentage points from a year ago. This suggests that respondents might be wary of the fallout from the trade conflict on China, including a slowing economy and its worsening debt problem. Not far behind China came Vietnam (28%), followed by India (26%), Europe (24%), and Indonesia (24%). Other investment destinations of interest included Mexico, where one respondent with U.S. investments has increased production capacity to cope with the trade conflict.

With a falling proportion of respondents interested in the U.S. and China due to trade tensions, the investment destinations of choice have shifted from primarily the U.S. and China to many more destinations in Asia and beyond. Several economies in South and Southeast Asia have become brighter spots for investors. Vietnam has emerged as a popular alternative production base outside China amid trade tensions. It surpassed the slowing European market to become the third most-invested destination in the last 12 months. Vietnam also replaced China as the top planned investment destination over the next three years. Some 40% planned investments in Vietnam, reflecting a six percentage-point increase from the previous year (see Figure 5). Meanwhile, India was one of the few countries that saw positive growth in investment interest over the past year. Although future investment interest in India has fallen, it was the joint second runner-up with the U.S., with 29% of respondents planning future investment in each country. Prime Minister Narendra Modi's reelection victory may have offered more stability and policy continuity for investors. One respondent looked to the electric vehicle market in India. Others saw India as a destination for manufacturers relocating from China due to rising wages and stricter environmental standards at home.

But not all ASEAN countries are poised to benefit from the investment diversion from the trade conflict. Indonesia (-10 percentage points), Philippines (-8 percentage points), Thailand (-6 percentage points), and Malaysia (-5 percentage points) saw considerable decline in respondents who planned investments in these countries. Domestic challenges in emerging economies, ranging from the dominance of state-owned enterprises in Indonesia to post-election political turmoil in Thailand, may have unnerved investors and

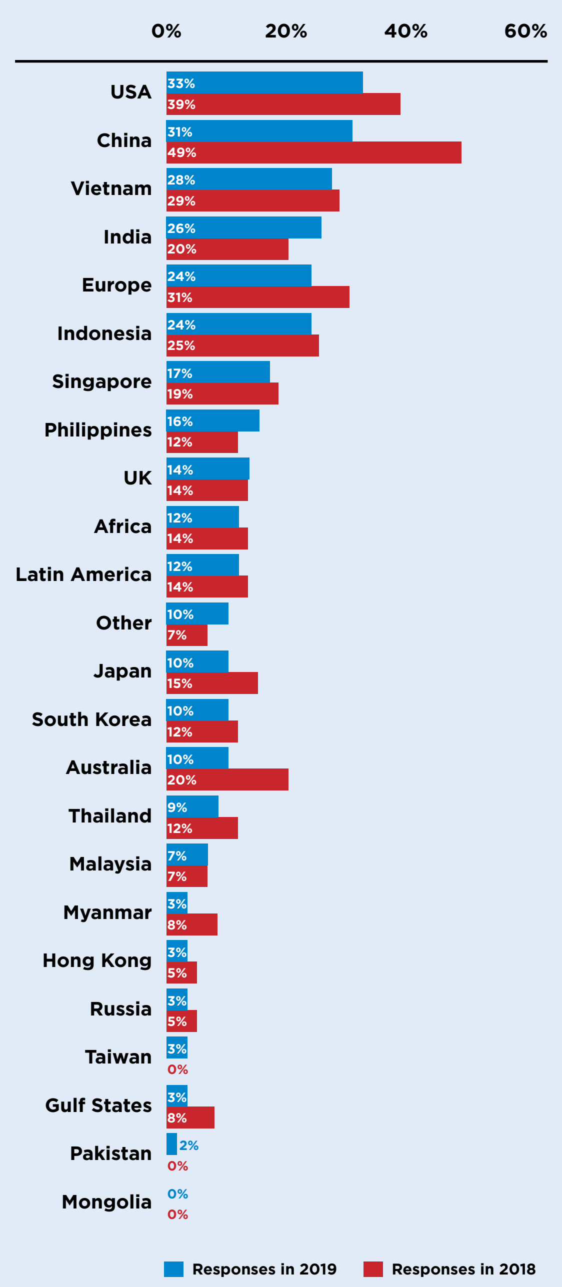

FIGURE 4
IN WHAT COUNTRIES HAVE YOU INVESTED OR INCREASED YOUR INVESTMENT?

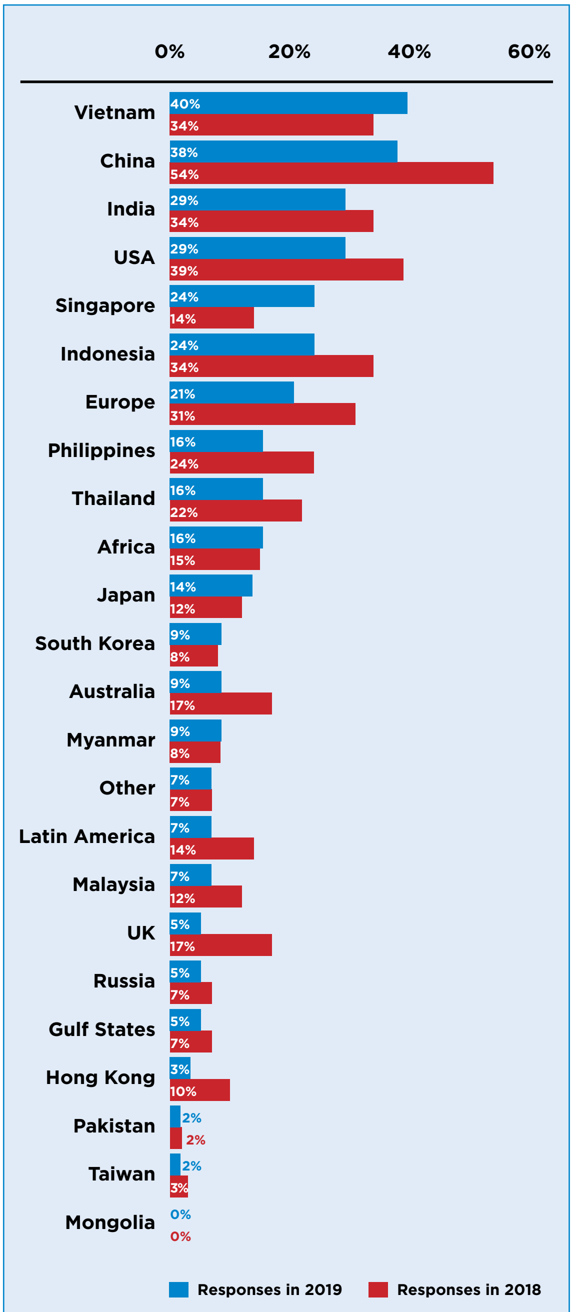

FIGURE 5
IN THE NEXT 1-3 YEARS, WHERE DO YOU PLAN TO INVEST OR INCREASE YOUR INVESTMENT?

turned them to stable, developed economies like Singapore (+10 percentage points). Another reason is that some companies still prioritize Vietnam for its better infrastructure and lower production costs compared to its ASEAN neighbors. As one respondent noted, the Philippines could be "an alternative investment destination for manufacturing, but [the] government is not moving to capture this opportunity."

TECHNOLOGY AND GEOPOLITICS TOP MEMBER CONCERNS

Technology tied with geopolitics as primary topics of concern for Asia business this year. Both were rated by 61% of respondents as very important (see Figure 6). Both technology and geopolitics were regarded as either very important or important by all respondents. Technological issues, which members were first asked about in last year's survey, topped the list of concerns for the second consecutive year. Digitization, seeking qualified talent, and keeping pace with technological innovation are cited as challenges for business, as are cybersecurity and data privacy. One respondent stressed the need for setting up global standards and laws on data usage. Geopolitics also moved to the top of members' concerns amid the U.S.-China trade conflict. While rising protectionism and weaponization of trade policies were identified as geopolitical threats, respondents were also concerned about the spillover of geopolitics into technology, such as the bifurcation of technology systems caused by escalating U.S.-China tensions.

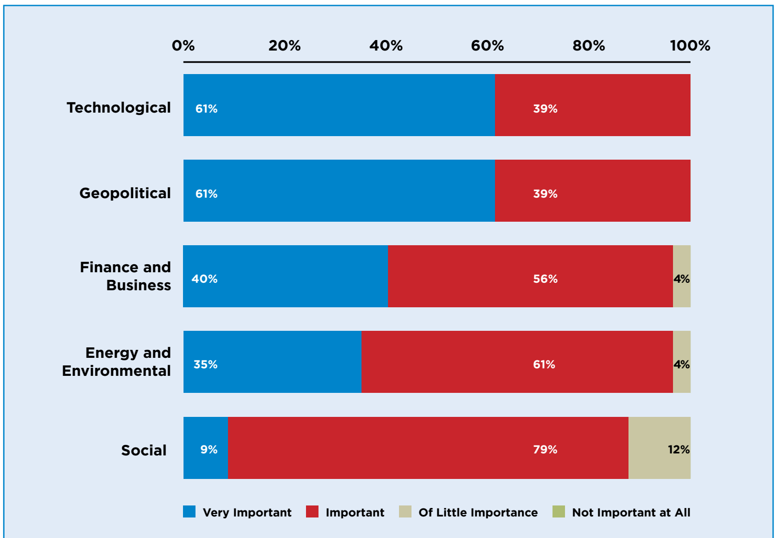

FIGURE 6
HOW IMPORTANT IS THIS ISSUE FOR BUSINESS IN ASIA?

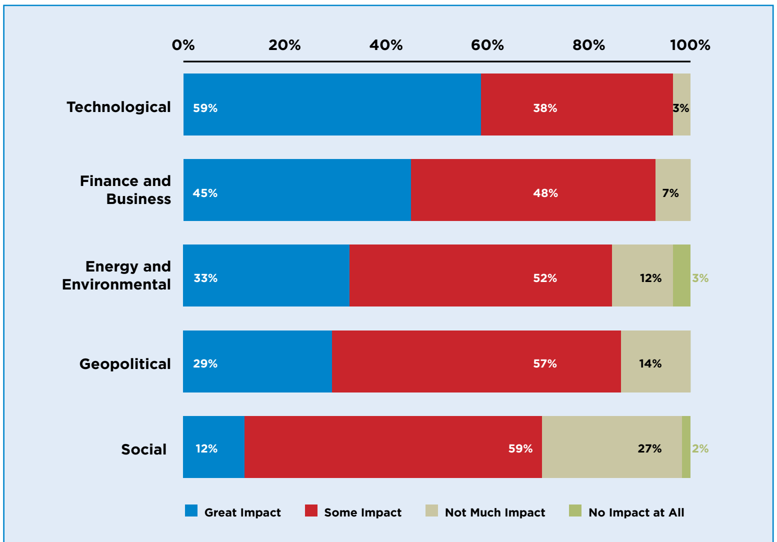

FIGURE 7
HOW MUCH DOES THIS ISSUE IMPACT YOUR BUSINESS?

Fewer members rated energy and environmental issues as very important this year (35%), as compared to 54% last year, but nearly all (96%) rated these issues as very important or important. Members were concerned about oil price fluctuations and the role business can play to decarbonize, achieve higher energy efficiency, and tackle plastic waste pollution. Finance and business issues were perceived by 40% of members as very important but remained substantial, with 45% rating them as having great impact on business (see Figure 7). Members mentioned lackluster growth in export-dependent Asian economies such as South Korea, and the likelihood of a global recession, both of which could be exacerbated by the U.S.-China trade conflict. The share of respondents seeing social issues having great impact on business remained roughly the same (12%) as last year. Some respondents said business should step up to tackle rising inequality and address the digital divide – between those benefiting from technological advancement and those falling behind – by upskilling employees.