

MONITOR

A BI-MONTHLY SURVEY OF SOUTHEAST ASIA

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THE REGION: Geopolitical Overview

The months ahead will see a jittery Southeast Asia awaiting further developments in the global and regional arenas. The impact of the devaluation of the Chinese yuan, nervousness in the wake of the 17 August bombing in Bangkok and approach of elections in Singapore and Myanmar are among the matters meriting close attention.

China's devaluation of its currency has sparked off another round of currency devaluations within and outside the region. Global and regional financial markets have been badly rattled by this development. Regional currencies are all down, giving the lie to the idea of strengthening economic and financial integration through ASEAN's evolving regional architecture. Several Southeast Asian currencies, notably the Malaysian ringgit and the Indonesian rupiah, fell to multi-year lows relative to the US dollar. China's economic performance significantly influences not just markets but also governments' and politicians' responses to market movements. Many governments in the region understand that those movements are viewed as a measure of their own performance and ability to deliver. While some observers note that the fluctuation in the value of the yuan has not been as severe as that in the values of other regional currencies, the possibility of further fluctuation and of resultant anxiety over the onset of a financial crisis merit attention.

The bombing of Bangkok's Erawan shrine has contributed to feelings of uncertainty across the region. While the hunt for the perpetrators continues, there are concerns that the attack may provide justification for the prolongation of military rule in Thailand. The motive and the actors responsible



for the atrocity remain unclear, but the spectre of religious sectarianism and its link to terrorism are on many minds. The blast has dealt a serious blow to a country and a region that wish to promote themselves as safe, welcoming destinations for visitors from around the world. The inevitably tighter security measures will also have an impact on efforts to achieve the seamless connectivity within an integrated community that ASEAN wishes to achieve.

The approach of elections in Singapore means that the incumbent government will seek to highlight its performance. In Myanmar, intense international attention during the run-up to the 8 November polls there will frame what is sure to be a bellwether campaign.

THE REGION: Economic Overview

Trouble looms for the economies of Southeast Asia, as the performance of their main export market, China, weakens. The RCEP agreement will be negotiated during the coming months and should be concluded by the end of 2015. It may provide a much-needed economic boost for the region.

The economies of Southeast Asia could be heading towards a lean period. In mid-August, Beijing abruptly devalued the yuan by 3.0 percent against the US dollar over the course of three days, in what some believe to be an attempt at reviving flagging Chinese exports. This devaluation triggered fresh concerns about the health of the world's second largest economy. Despite being a relatively modest devaluation, the move may indicate that China's growth is weaker than the official 7.0 percent *per annum* reported in July – a figure whose reliability some observers had already questioned. If China is indeed *en route* to another slowdown, Southeast Asia's economies will suffer. Weak Chinese demand will continue to affect the economies of Southeast Asia. Indonesia, Malaysia, Singapore and Thailand, all reliant on exports to China, will be especially hard hit; the latest manufacturing data from these countries are poor. For Malaysia, this is another problem that its economy – bedeviled already by a weakening currency, political turmoil, and slowing growth – can scarcely afford. Additionally, any further devaluation of the yuan could increase trade tensions at a time when negotiations for two large Asia-Pacific trade agreements, the Trans-Pacific Partnership and the

Regional Comprehensive Economic Partnership (RCEP), are taking place. The latter agreement – among the ASEAN member states, Australia, China, India, Japan, the Republic of Korea and New Zealand – should be concluded by the end of this year. It is poised to boost the economies of its members, and any delay in the completion of the agreement may affect investor confidence in the region.

Southeast Asia can expect little benefit from the performance of other major East Asian economies, which continue to be feeble. Weak domestic consumption and poor export performance caused Japan's economy to contract by 0.4 percent in the second quarter, calling into question the efficacy of Abenomics. Similarly, South Korea's economy grew by a measly 0.3 percent during that quarter, after the outbreak of Middle East Respiratory Syndrome affected domestic consumption.

The stability of economies further afield should, however, provide a small measure of relief for the region. The US economy expanded at a modest rate of 2.3 percent in the second quarter, and unemployment there is down to a healthy 5.3 percent. In the Eurozone, Greece has secured its third bailout, worth €86bn, after a bitter six-month battle against domestic and German opposition. The diminishing of fears of a "Grexit" for the time being marks the beginning of greater economic stability and recovery in Europe.

Real GDP Growth in Southeast Asia and Selected Asian and Developed Economies (year-on-year percentage changes)

	2012	2013	2014	2015	2016
Brunei Darussalam	0.9	-1.8	-0.7	-0.5	2.8
Cambodia	7.3	7.4	7.0	7.2	7.2
Indonesia	6.0	5.6	5.0	5.2	5.5
Lao P.D.R.	7.9	8.0	7.4	7.3	7.8
Malaysia	5.6	4.7	6.0	4.8	4.9
Myanmar	7.3	8.3	7.7	8.3	8.5
Philippines	6.8	7.2	6.1	6.7	6.3
Singapore	3.4	4.4	2.9	3.0	3.0
Thailand	6.5	2.9	0.7	3.7	4.0
Vietnam	5.2	5.4	6.0	6.0	5.8
ASEAN-10 Average	5.7	5.2	4.8	5.2	5.6
China	7.8	7.8	7.4	6.8	6.3
India	5.1	6.9	7.2	7.5	7.5
United States	2.3	2.2	2.4	3.1	3.1
Japan	1.8	1.6	-0.1	1.0	1.2
European Union	-0.4	0.1	1.4	1.8	1.9
World Average	3.4	3.4	3.4	3.5	3.8

Source: IMF, World Economic Outlook Database, April 2015.

Manufacturing Purchasing Managers' Indices of Key Economies (2015)

	May	June	July
Australia	52.3	44.2	50.4
China	49.2	50.2	50.0
Eurozone	52.2	52.5	52.4
India	52.6	51.3	52.7
Indonesia	47.1	47.8	47.3
Japan	50.9	50.1	51.2
Singapore	50.2	50.4	49.7
South Korea	47.8	46.1	47.6
Taiwan	49.3	46.3	47.1
United States	54.0	53.6	53.8
Vietnam	54.8	52.2	52.6

Sources: Australian Industry Group, Hongkong and Shanghai Banking Corporation, Markit Economics, National Bureau of Statistics, China, and Singapore Institute of Purchasing & Materials Management. The Purchasing Managers' Index (PMI) is a leading economic bellwether. Based on surveys of selected companies on five indicators – employment environment, inventory levels, new orders, production and supplier deliveries – it is an indicator of the manufacturing sector's health. Because of the world's highly connected value chains, the PMI performance of advanced countries provides a good forecast of Southeast Asia's economic health. A PMI reading of more than 50 indicates an expansion in the manufacturing sector from the previous month. A reading of less than 50 indicates a contraction, while a reading of 50 represents no change.

CAMBODIA

The ruling party is likely to continue suppressing the political opposition and civil society. Freedom of expression will deteriorate.

Phnom Penh government's suppression of a wide range of actors, from the political opposition to student associations, will define the months ahead.

The Cambodian People's Party (CPP) administration is likely, first, to pressure the opposition Cambodia National Rescue Party (CNRP) to retreat from its provocative stance concerning Cambodia's border with Vietnam. Eleven imprisoned opposition activists and one opposition senator will remain behind bars, with further arrests a possibility. In the context of a more engaged and better informed public, it remains unlikely that the CPP will resort to severe measures such as, for example, the assassination of opponents. Nevertheless, a weakened opposition may move away from its stance on the border issue; it has already shown some willingness to compromise with the CPP. Accommodation looks like the CNRP's only option, since the government seems less vulnerable than in the past to international pressure to change its behaviour.

Cambodia's new NGO law will render NGOs such as those promoting human rights and democracy increasingly cautious. They will adjust their strategies to survive in a politically constrained atmosphere. The same behavior may characterize trade unions, under a separate law awaiting passage.

The CPP will also seek to keep both student groups and universities under control. It will employ threats to pressure university students and student movements, and even university faculty, to disengage from politics. These threats will seek to choke off political expression in social media platforms such as Facebook.

The CPP—represented above all by charismatic figures in its leadership such as Commerce Minister Sun Chanthol—will work to attract or buy support in its usual manner, by visiting the countryside and distributing gifts. Serious institutional reform is not in prospect.

This grim political outlook notwithstanding, the business sector and the economy are likely to function with little disturbance. The donor community, some of whose members are tired of

Cambodian politics, may monitor developments on the political scene. It remains to be seen if the United States will react to those developments.



INDONESIA

Indonesia's recent cabinet reshuffle signals its president's continuing difficulties in delivering on policies and managing the economic downturn. He will face continued political and economic problems as he juggles various interests and confronts pressures from a range of sources.

In an effort to address problems of coordination among his ministers, declining economic growth and his government's decreasing popularity, President Joko "Jokowi" Widodo has replaced a number of cabinet members. Among the new ministers are Darmin Nasution, formerly Central Bank Governor and now Coordinating Minister for the Economy; retired General Luhut Pandjaitan, formerly presidential chief of staff and now Coordinating Minister for Political Affairs; Rizal Ramli, Coordinating Minister for the Economy and Finance under President Abdurrahman Wahid and now Coordinating Minister for Maritime Affairs; and Pramono Anung, former secretary-general of the ruling Indonesian Democratic Party-Struggle (PDIP) and now Cabinet Secretary.

The new ministers are tasked with seeing that Indonesia reaches a target of 5.2 percent economic growth, keeping inflation under 5.0 percent, and maintaining an exchange rate of IDR 12,500 per US dollar. Because of the depreciation of the Chinese yuan, the rupiah has slid to a rate of some IDR 13,900 per US dollar. The presence of more PDIP party cadres in the cabinet indicates the intensification of the party's pressure on presidential policy-making. Jokowi also faces criticism for endorsing proposals to reinstate a draconian defamation law. In the months ahead, the relationship between the president and the PDIP and the impact on policy of both that relationship and the cabinet reshuffle will bear watching.

As part of the move toward simultaneous direct elections for regional leaders (Pilkada) due in December 2015, the General Election Committee received applications from 827 two-person tickets of aspiring regional chiefs, accounting for 269 regions across Indonesia. Seven regions, in which only one ticket registered, were granted an extension on the application period. Nevertheless, four regions still failed to register additional candidates and will postpone elections until 2017. Parties seem to have chosen deliberately not to register or endorse candidates, and there has as a result been calls for the president to issue a government regulation in lieu of law (Perppu) to address this problem.

Indonesia's economic growth slowed down slightly from 4.72 percent in the first quarter to 4.67 percent in the second. Household consumption, traditionally the most important economic driver, has weakened in the face of high inflation and depreciation of the rupiah. Other significant contributors to GDP growth—including manufacturing, trade and mining—have also slowed. China's economic slowdown, weak commodity prices and possible interest rate hikes in the US raise the prospect of capital outflows from Indonesia, further depreciation of the rupiah, and greater difficulty financing infrastructure projects.

Indonesia's growth rate for the year is likely to be below the 5.2 percent target. The Jokowi government faces pressure to expedite government spending to spur economic growth. Acceleration of infrastructure spending will present challenges, however, as bureaucratic inefficiency and poor coordination slow capital expenditure.

MALAYSIA

With Najib pre-occupied with his political survival in the face of the 1MDB scandal, Malaysia's economy is expected to suffer further as a result of negligence and mismanagement. Political uncertainty may continue to negatively affect investors' confidence.

New revelations over his links to the 1Malaysia Development Berhad (1MDB) financial scandal will further batter Prime Minister Najib Razak's credibility. The scandal has already precipitated a deep political crisis. It brought Najib's dismissal from his cabinet, of critics such as Deputy Prime Minister Muhyiddin Yassin, who had openly disapproved of the premier's handling of the 1MDB scandal. Public institutions tasked with probing the 1MDB affair have also been compromised, as the government deliberately sabotaged their investigations by removing, reassigning and harassing key officials in those institutions.

Najib will forcefully clamp down both on growing dissent within UMNO and on the opposition. But calls for his resignation may be expected to continue. The ranks of his detractors in the ruling party are growing fast, and these have started to mobilize around senior UMNO figures such as Tun Dr Mahathir Mohamad, Tengku Razaleigh Hamzah and Muhyiddin Yassin, who remains the party's deputy president. Recognizing that it is almost impossible to remove Najib as UMNO's president, his detractors in the party will try to ally with the opposition to oust him through a parliamentary vote of no confidence. But this move is likely to fail, as the speaker of parliament will almost certainly refuse to permit such a motion. In addition, Najib has retained the support of the overwhelming majority of UMNO/Barisan Nasional parliamentarians, and he may also garner support from PAS's ulama faction. In the meantime, the progressive faction of that latter party, together with Muslim civil society will form a new Islamist party and enter into a reconfigured opposition coalition with the Parti Keadilan Rakyat and the Democratic Action Party.

Unfavourable developments, both domestic and international, will confront the Malaysian economy in the coming months. Commodity prices, especially for oil, may drop lower on weak demand from China and Europe. In fact, oil prices may fall even further if Iranian oil is again available on international markets. A rise in interest rates in the United States will result in accelerated capital flight from Malaysia and further depreciation of the ringgit. Imports will then become costlier, and

inflationary pressure will increase. The fiscal deficit is likely to exceed the government's target of 3.2 percent of GDP.



MYANMAR

In the months ahead, the Myanmar political scene will be dominated by election campaigns and strategies. Floodwaters that have hit the country will recede, but crop losses will affect many farmers. The government's response to the floods and their aftermath will have an impact on voting behaviour, particularly in most seriously affected regions.

The candidates have registered and the campaigning has begun – Myanmar's general election season is under way. With voters due at the polls in early November, the minor controversy generated by the candidate list of the National League for Democracy (NLD) has been overtaken by an internal coup in the ruling Union Solidarity and Development Party. August saw the abrupt removal of party chairperson Thura Shwe Mann from its leadership and his replacement with the deputy head of the party, U Htay Oo. The speculation is that President Thein Sein is considering a second term as president; Thura Shwe Mann's chances of becoming president now appear much diminished.

Floods from monsoon rains damaged settlements and crops in the Sagaing Region and elsewhere, affecting one million people and bringing a death toll of around 100 people. As evacuations and emergency relief continued, the UN Office for the Coordination of Humanitarian Affairs praised the aid efforts of local communities and organisations.

The floods dealt a particularly heavy blow to Myanmar's rice sector: some 1.3 million acres of paddy fields have been swamped, according to the Myanmar Rice Federation. The way in which the government handles the floods and their effects is likely to have an impact on how people will vote in these areas. Further, the consequences of crop losses for Myanmar rice export and import policies bear watching, as does the dramatic rise in rice prices in flood-hit areas.

The floods present opportunities for all political parties to further their goals in the general election. Aung San Suu Kyi and the NLD, for example, have been visiting affected areas, appealing for donations of food aid and encouraging people to vote.

THE PHILIPPINES

The Aquino administration has been very successful in gaining extra-regional support for its position on the South China Sea specifically and for Philippine military modernization generally. It will be difficult and costly for Aquino's successor to reverse either policy after she or he takes office in 2016.

The Philippines' case against China's nine-dash line claim in the South China Sea has garnered not only extensive coverage but also substantial diplomatic support for the country from a number of major powers, including the United States, Japan, the European Union and Australia.

While ASEAN has offered its member-state less fulsome support, major-power support goes well beyond diplomatic *bons mots*. The Philippine Coast Guard and Navy are receiving in the form of aid or on concessional terms a growing number of new and second-hand vessels from the country's allies and security partners such as Japan, the United States, Australia and the Republic of Korea.

In June, Japan and the Philippines signed an enhanced security agreement and began negotiations on a status-of-forces agreement. In July, the two countries also conducted a bilateral naval exercise in the West Philippine Sea featuring the Japanese P-3C Orion anti-submarine surveillance plane that the Philippines is considering buying. Japan also joined for the first time in the US-Philippine CARAT exercises, again held in the West Philippine Sea.

The Philippines and South Korea have agreed to fast-track Manila's purchase of Korean FA-50 jets in the face of Chinese opposition. These planes will be the country's first fighter jets in a decade—the Philippine Air Force decommissioned its aging and decimated fighter jet fleet in 2005.

In 2016, the Philippines plans to reopen the Subic Bay naval base, the core of the US military presence in Southeast Asia until 1991.

SINGAPORE

The General Election has been announced, and the PAP is in a strong position to do well. The Australia-Singapore comprehensive strategic partnership reflects Singapore's determination to build deep strategic and economic ties with Pacific powers.

With the National Day celebrations that marked Singapore's 50th year of independence over, the government has now announced that the General Election will be held on 11 September 2015. Political parties have begun to prepare the ground for their campaigns, and most have announced the candidates due to contest the various Single Member Constituencies (SMCs) and the Group Representation Constituencies (GRCs). Redrawn electoral boundaries divide the city-state into twenty-nine electoral divisions, two more than in the 2011 election. This new map will give opposition parties more chances to contest People's Action Party (PAP) dominance.

Results from a survey commissioned by MediaCorp show that the majority of Singaporeans are satisfied with the government's recent performance in most areas. However, living costs, rising housing costs and management of the influx of foreigners into the country remain sources for some dissatisfaction. PAP politicians have described the coming polls as "watershed elections"—these being the first since the death of the nation's founding father and the lynch-pin of the PAP, Mr Lee Kuan Yew. This confluence of factors and the measures that the party have introduced to address grievances mean that the PAP looks strong, is likely to hold onto seats won in 2011 and will possibly recoup losses suffered that year.

Singapore has also signed a comprehensive strategic partnership agreement with Australia. This is the latest development in Singapore's evolving ties with key extra-regional powers. It aims at close bilateral ties in four areas: economics, foreign affairs, security and people-to-people relations. Singapore is Australia's fifth largest trading partner, and Singaporean investment in Australia exceeds S\$44 billion. More than 20,000 Australians live in Singapore, while more than 50,000 Singaporeans live in Australia. Ties between the two societies are broad and deep.

THAILAND

The final draft of Thailand's proposed new constitution will shape political debate in the country in the months ahead. The dictatorship's new economic team faces formidable challenges on the domestic, regional and international fronts. Investigations into the Erawan shrine bombing will subject Thai authorities to heightened scrutiny.

The first week of September will see Thailand's National Reform Council (NRC) vote to approve, or not, the final draft of the country's proposed constitution. A "steering committee" meant to guide continued "reform" will then replace the council. The terms of the draft charter and the activities of the new committee will offer signals about the National Council for Peace and Order (NCPO) junta's plans for progress toward the political system that will replace military dictatorship. (NRC rejection of the draft will delay, rather than fundamentally change, those plans.) Even in the context of highly constrained public expression, debate over the proposed charter in the run-up to a referendum on the document in early 2016 will be one of the two principal foci of Thai politics in the months ahead.

The second focus will be the economy. The dictatorship's new deputy prime minister for economic affairs, Somkhit Chatusiphitak, will bring energy, leadership, improved coordination and perhaps fresh ideas to address the country's economic problems. Deep uncertainty about the performance of the tourism sector and about the loan portfolios of Thai banks, rising levels of household debt and of defaults on debt repayment, and a shrinking export sector will leave the NCPO nervous about its popularity. Along with these domestic factors, increasingly negative investor sentiment toward Southeast Asia as a whole, slower growth and turmoil on the equities markets in China, and determination in the United States to raise interest rates only compound the challenges facing Dr Somkhit and his team.

Thai authorities' efforts to learn who was responsible for the deadly bombing of Bangkok's Erawan shrine on 17 August and to bring that party to justice will continue. Pointing to international involvement in the attack, informed analysis centres on pan-Turkic elements seeking revenge for Bangkok's decision earlier this year to return Uighurs who had left China, back to that country against their will. This theory suggests that the bomber and any accomplices are no longer in Thailand. While not likely to be related either to Thailand's bitter domestic political divide or to separatism in the far

south of the country, the bombing has exacerbated the tension that has prevailed since the May 2014 coup d'état.



VIETNAM

The 13th National Assembly will hold its final plenary meeting in October and November—its last chance to pass important legislation prior to the National Party Congress and elections in 2016. The government and the State Bank of Vietnam will continue to study how recent fluctuations in the value of the Chinese yuan will affect Vietnam’s currency and trade. The State Bank has widened the trading band of the Vietnamese đồng, which is pegged to the USD, from +/- 1.0 percent to +/- 2.0 percent.

Disappointment looms in Vietnam over talks on the twelve-nation Trans-Pacific Partnership (TPP), after parties failed to reach a final agreement in Hawaii in July. Obstacles to agreement had little to do with Vietnam, but they revealed new uncertainties for an agreement in which proponents of both economic and political reforms in Vietnam had invested much hope. In partial consolation, however, Vietnam reached an in-principle agreement on free trade with the European Union, which is expected to come into effect in late 2017 or early 2018. If one of the main objectives of Vietnam’s participation in the TPP is to reduce the country’s economic dependence on China, a free trade agreement with the EU—with which its two-way trade was valued at nearly US\$40 billion last year—certainly helps it meet that objective.

The EU deal was announced on the back of other important free trade agreements signed earlier this year and of a second-quarter GDP growth rate of 6.4 percent—slightly higher than the figure of 6.1 percent for the first quarter and more than a full percentage point higher than that for the second quarter of 2014. The main source of recent growth has been the industrial sector, whose performance helped offset slower growth in agriculture. New legislation has also been passed to lift limits on foreign ownership of listed firms, previously set at 49 percent. This measure reflects Vietnam’s slow but steady commitment to market reforms. However, the legislation exempts the banking sector, suggesting some reluctance to push through much-needed banking reforms.

Vietnam also continues to bolster its relations with the United States, with General Secretary Nguyễn Phú Trọng making an historic visit to Washington in July. It was the first such visit ever to be made by a Vietnamese Communist Party chief, and it was especially significant because of Nguyễn Phú Trọng’s having typically been tagged as leader of the conservative pro-China faction within the

Politburo. Among the topics discussed during the trip were plans to upgrade the two nations' diplomatic relations to an "extensive comprehensive partnership".



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