Grant Thornton
An instinct for growth™

The future of Asia-Pacific

Grant Thornton International Business Report 2015

Introduction

Asia-Pacific (APAC) is a region of huge diversity, not only culturally and geographically, but economically too. Japan is a member of the G7 and a world leader in automotive and technology. Singapore competes with London and New York as a global financial centre. Australia and New Zealand are sometimes treated as a region in their own right due to both geography and culture - it takes over 12 hours to fly from Delhi to Sydney and history ties them more to the UK and US - but they are increasingly connected to Asia through trade.

Some of the region's emerging nations are so important to the global economy that they cannot be treated as a single mass. China is the world's most populous county, its biggest trader and its second largest economy (although on a purchasing power parity or PPP basis, its largest). India will soon overtake China in terms of population and its economy is now estimated to be growing faster. Southeast Asian countries are increasingly acting as a collective unit, exemplified by the burgeoning ASEAN economic community – collectively the world's seventh largest economy.

As well as diversity, APAC also offers great opportunity. It is home to some of the best business growth environments in the world according to our Global Dynamism Index (GDI). This ranking of the business growth environments of 60 leading economies places Singapore top overall, with Australia third and Taiwan also in the top ten. New Zealand (13), China (14), Malaysia (16) and South Korea (18) also perform well. Developed APAC economies score well for business operating environment and technology, while emerging peers rank high for labour market and market growth.

Growth rates in the region are among the fastest in the world, helpingto support innovation and vital infrastructure developments. The local population is relatively youthful and the establishment of the Asian Infrastructure Investment Bank (AIIB) will further increase opportunities for dynamic businesses across the region. The signing of the Trans-Pacific Partnership (TPP) which covers 40% of global output and links much of the region to fast-growing economies in the Americas is a further boost to growth prospects.

Our advisers stand ready to help you make the most of the myriad opportunities presented by this fascinating region. APAC is booming. Don't miss out.

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Economic outlook

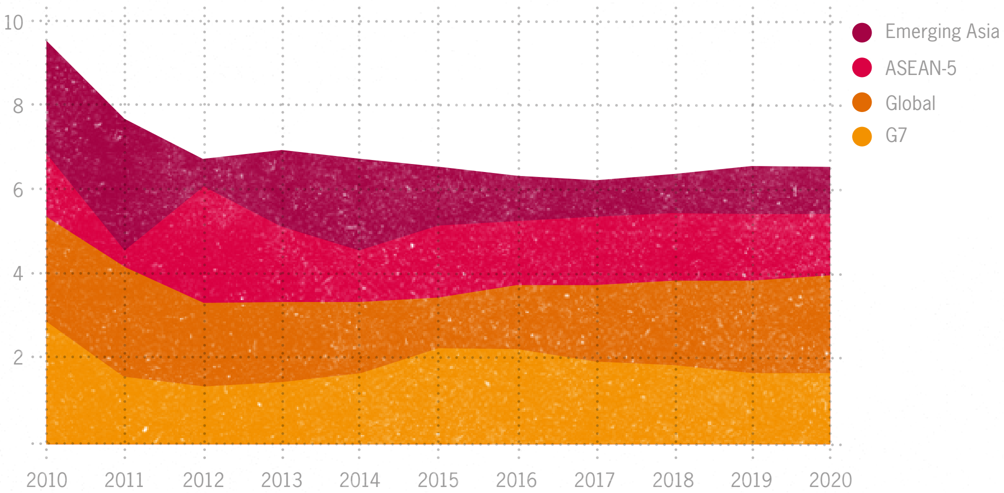
Despite recent turmoil in China, the economic outlook for APAC is healthy. Economic growth for the emerging economies in the region is expected to average 6.6% over the next five years, down from double-digit rates pre-financial crisis but far quicker than advanced economy peers. The G7 economies are forecast to expand by just 2.0% per annum on average over the same period.

This disparity in growth rates has already resulted in a large shift in economic power from West to East. Over the past five years, emerging APAC's share of global output (on a PPP basis) has risen by almost five percentage points to 30.5%. A similar rise is forecast over the next five years to 34.5% with the share of the G7 declining to 29.0%, down from 34.7% in 2010.

However, as discussed in the next section, emerging APAC is home to a huge number of people so living standards across the region remain some way behind those of the G7. Currently GDP per capita (on a PPP basis) is approximately a fifth of the G7, but it is catching up fast: in 2010, GDP per capita across emerging APAC was a sixth of that in the G7, but is forecast to climb to a quarter by 2020.

Growth rates across emerging Asia forecast to remain above the global average

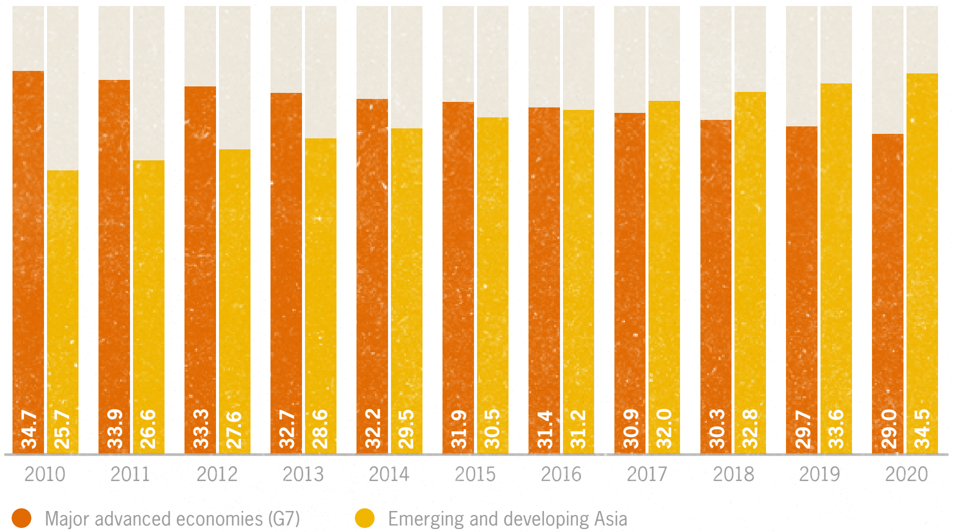
Real GDP growth (%)



Source: IMF 2015

Emerging Asia set to account for a larger share of global output than G7 by 2017

Percentage share of global GDP (PPP)



Source: IMF 2015

Demographics

The economic outlook of APAC is bound up with its demographic outlook. The region is currently home to three of every five people on the planet.

UN populations projections expect this to shrink to one in two by 2070, mainly due to a surge in Africa's population - which is expected to almost triple over this period - but also to a rapid decline in birth rates across much of the region. Fertility rates are already well below the replacement level of 2.1 births/woman - the level at which the population remains stable. Consequently Japan (1.4) and China (1.7) are ageing rapidly - Japan's population has already started to decline while China's is expected to peak in 2030.

However there is some variation across the region. Australia's fertility rate (1.9) is below the replacement level but its population is expected to continue to rise due to immigration. Singapore (1.2) and Thailand (1.4) have even lower fertility rates. By contrast, the populations of India (2.5) and Indonesia (2.3) - already the second and third most populous countries on earth - continue to grow.

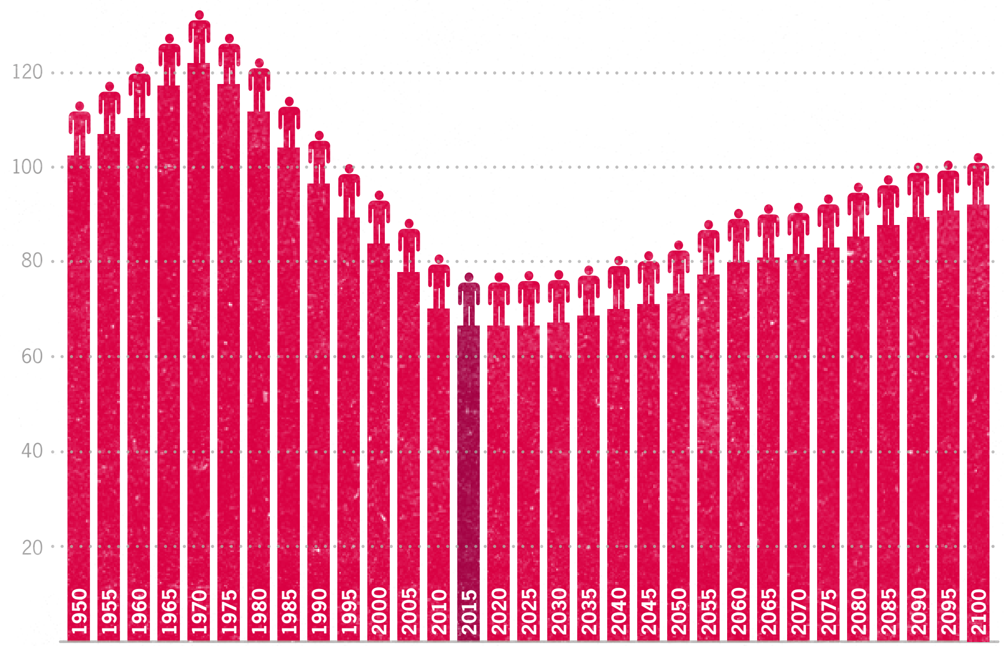
Population levels are important because of the potential boost they can offer an economy through the so-called demographic dividend, where more people of working age are supporting relatively fewer dependents (the young and the old). The dependency ratios of APAC has been falling since 1970. This means, for example, that relatively more people are paying income taxes compared to those claiming state pensions, boosting government finances. However, current estimates suggest that the dependency ratio across the region has already bottomed out and will start to rise from 2030.

Outside India and Indonesia, working age populations will soon begin shrinking

For standards of living to be at least maintained as dependency ratios rise, the shrinking workforce needs to become more productive. However, estimates from McKinsey suggest that productivity growth would have to almost double to 3.3% to "compensate fully for slower employment growth." In economies where dependency ratios are still falling, there is still time to benefit from the demographic transition, although this will require a huge increase in job creation.

The APAC demographic transition may already be over

APAC dependency ratio*



*Dependecy ratio calculated as 0-19 and 65+ years old as percentage of 20-64 year olds

Source: UN Population Division 2015

Business growth landscape

Business confidence across the region declined in Q3 as strong global headwinds, including a slowdown in global trade and uncertainty over China's growth path in particular, weigh on the outlook.

Optimism in the economic outlook dropped from net 42% to just 20% across APAC, its lowest level since the second quarter of 2013. The decline in developed markets was most severe (down 30pp to net -8%) but emerging markets also saw a steep decline (down 18pp to net 34%). The biggest fallers were China (down 20pp to net 26%), Japan (down 36pp to net -8%) and ASEAN (down 22pp to net 18%).

The business growth outlook also suffered in Q3. Expectations for raising revenues dropped to net 38% in APAC, down 10pp from Q2 – the lowest since the second quarter of 2012. This mirrors a global decline – down 6pp to net 48%. The decline was strongest among developed APAC nations (down 17pp to 32%) driven by Australia (down 28pp to net 38%) as the country comes to terms with lower commodity prices.

Profitability indicators have also fallen across the region, but by only 7pp at the aggregate level to net 27%. Indeed expectations for increasing profitability in emerging APAC remain level with the global average at net 34%, although advanced nations are collectively less optimistic (net 12%, down 15pp from Q2).

One reason for this decline in growth prospects is the slowdown in trade, with net 0% of businesses in ASEAN expecting to increase exports over the next 12 months, a 17pp drop from Q2. Export expectations for the region as a whole have slipped well below the global average.

Growth constraints

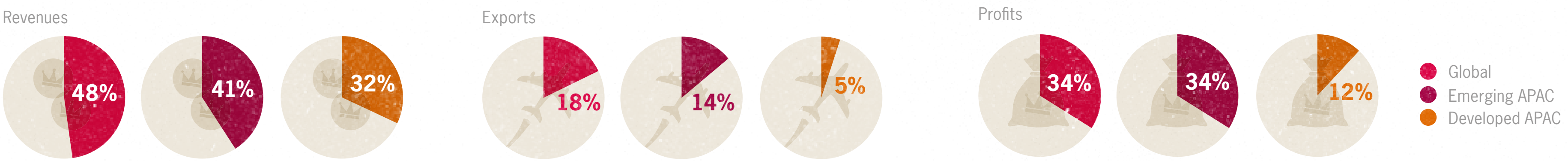
Globally, the major constraint on business growth is economic uncertainty (39%) as it is across APAC – although at a much higher level. More than one in two businesses in advanced APAC economies say uncertainty is constraining their growth prospects (55%) slightly above the figure for emerging economies (43%).

APAC businesses are concerned by uncertainty, low demand and rising energy cost of energy

However, this is also a time when APAC businesses feel under pressure in a number of areas. More than half of advanced economy businesses are seeing low demand for their products and services (51%) and although this drops to 37% for emerging economies, it remains well above the global average (33%).

Rising energy costs are also a concern across the region despite low global oil prices. More than two in five APAC businesses cite energy costs as a growth constraint compared to 29% globally. And a lack of skilled workers is a concern for a further 43% of business leaders in advanced APAC.

Net percentage of businesses expecting an increase
(next 12 months)



Source: Grant Thornton IBR 2015

The future of APAC

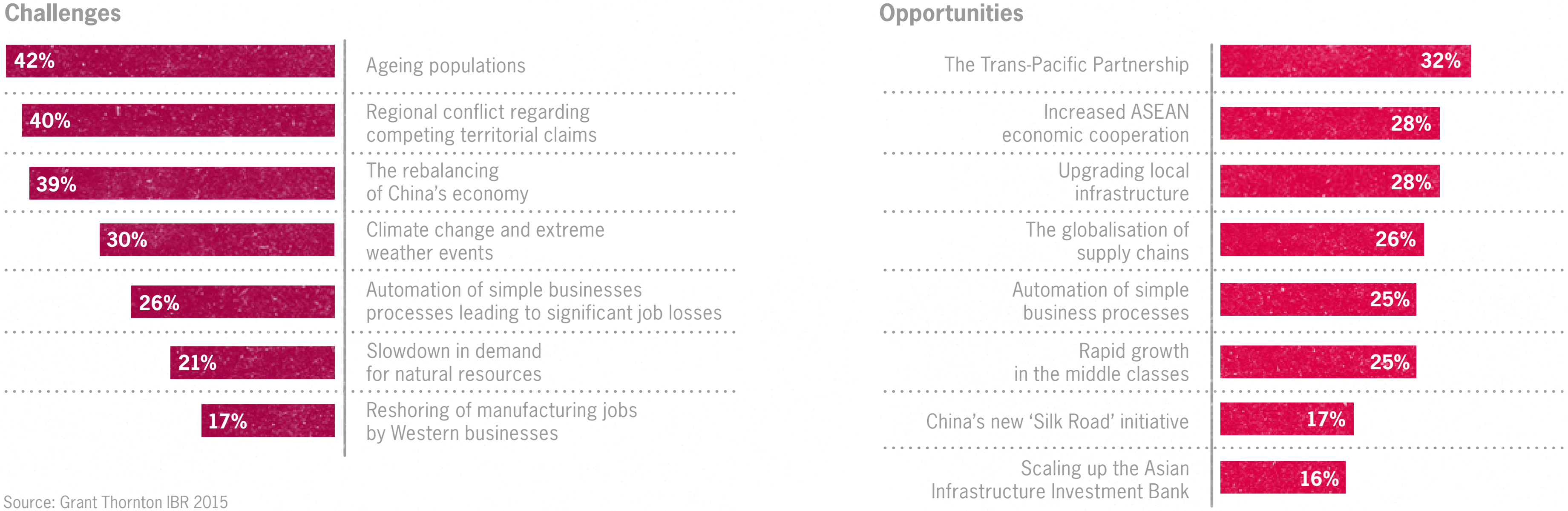
We asked business leaders what they believe to be the biggest opportunities and challenges for APAC over the next five years.

The Trans-Pacific Partnership (TPP) emerged as the greatest opportunity across the region (32%). TPP would become the largest trading bloc on the planet, covering around 40% of the global economy. However negotiations – which include Australia, Japan, Malaysia, New Zealand, Singapore and Vietnam together with the US and some Latin American nations – have yet to be ratified by national governments, including the US Congress.

Increased ASEAN economic cooperation and upgrading local infrastructure were both cited by 28% of businesses. The realisation of the AEC would significantly increase the bargaining power of Southeast Asia while infrastructure remains a concern across the region (particularly for business leaders in India, the Philippines and Thailand).

In terms of challenges, business leaders cited ageing populations at number one (42%). As discussed earlier, much of the region is growing older which could result in skills shortages and fiscal deficits. Regional territorial disputes (40%) were also widely cited, perhaps reflecting competing maritime claims especially in the South China Sea. And a further 39% cited the rebalancing of China's economy – the move from investment to consumption has already hurt commodity exporters across the world and any 'hard landing' would have repercussions across the region.

Greatest challenges and opportunities for APAC
(next 5 years)



Source: Grant Thornton IBR 2015

ASEAN

Southeast Asian economies are increasingly acting as a collective unit, using their combined economic and political clout to push local interests. Taken together, these 10 nations are the seventh largest economy in the world and will be the fourth largest by 2050 on current growth projections.

The performance of ASEAN nations in the GDI is mixed. Singapore ranks top globally highlighting its broad-based offer to growing businesses. Malaysia (16) and Vietnam (28) also rank in the top half of the index, followed by the Philippines (33), Indonesia (40) and Thailand (47).

Business optimism across ASEAN dropped 22pp in Q3 to net 18%. The slowdown in China seems the likeliest explanation given the large and growing share of ASEAN exports which head that way - tellingly export expectations have collapsed from net 17% to net 0% over the past three months. The Philippines saw a slight increase in optimism but Indonesia (down 24pp), Malaysia (down 23pp), Singapore (down 46pp) and Thailand (down 18pp) all saw big falls.

The proportion of ASEAN businesses citing exchange rate fluctuations (50%) and economic uncertainty (45%) further adds to the sense that local businesses are struggling with developments in China where the authorities recently devalued the renminbi.

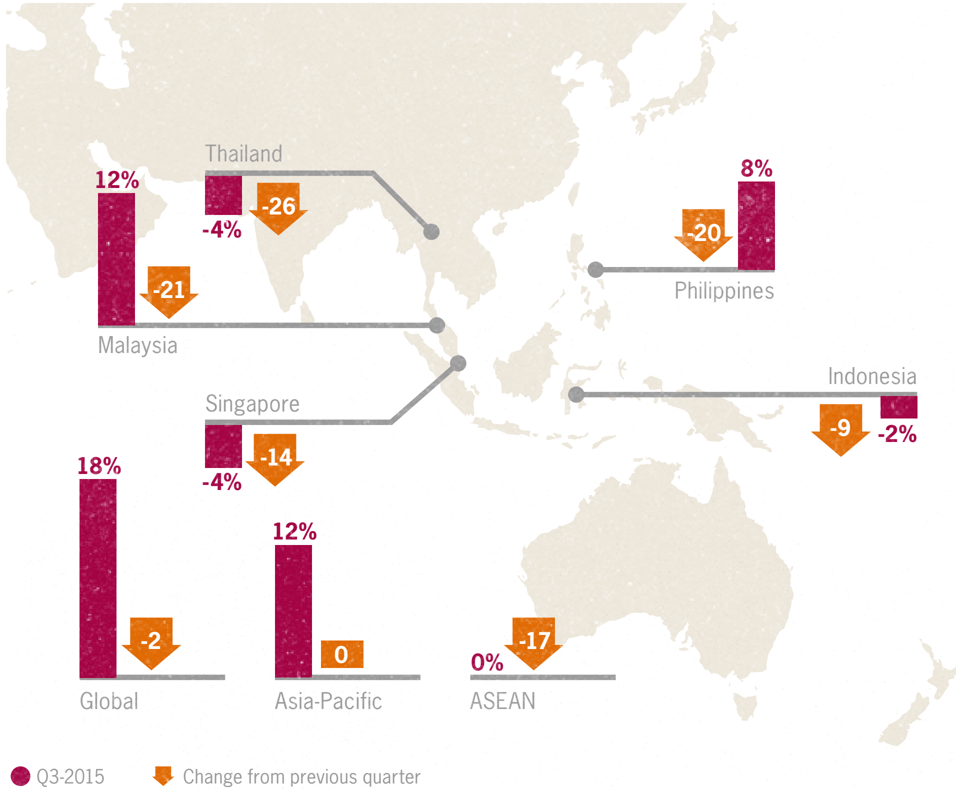
Perhaps unsurprisingly, ASEAN business leaders see increased cooperation across their economies as the biggest opportunity for the wider region over the next five years.

Weak Chinese demand is weighing on business growth prospects

Thai businesses are the most positive (72%) with peers in Singapore (50%) the least. Philippines businesses are also excited about upgrading local infrastructure (66%).

ASEAN business leaders cite regional conflict regarding competing territorial claims as the key challenge for the region, an issue evident in disputes over the South China Sea. The Philippines (66%) and Indonesia (58%) are particularly concerned in this regard. Businesses in Malaysia are also concerned about the rebalancing of China's economy and a slowdown in demand for natural resources (both 48%). Half of Singaporean businesses believe ageing populations are a key challenge.

Net percentage of businesses expecting to increase exports
(next 12 months)



Source: Grant Thornton IBR 2015

Australia and New Zealand

Australia and New Zealand are both signatories to the TPP but are very different sizes. Australia is the twelfth largest economy in the world and home to over 23m people. New Zealand has a population of under 5m people and its economy is approximately an eighth of the size of its larger neighbour.

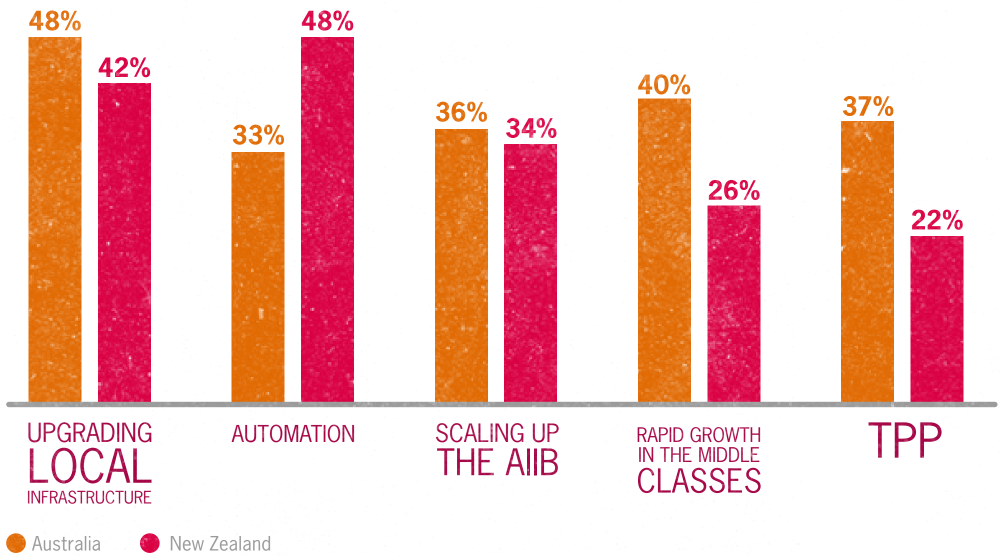
It takes almost four hours to fly from Auckland to Sydney, but the countries are similar culturally – certainly in comparison with the rest of the region – and both offer very dynamic business growth environments. Australia ranks 3 globally, driven by a robust business operating environment (rank 4) and a strong labour market (rank 3). New Zealand ranks a little lower at 13 but offers strong business operating (11) and financing (8) environments to growing businesses.

Both economies have free trade agreements with China and are heavily reliant on exports to the regional superpower – around a third of Australia's exports and a fifth of New Zealand's go there. Given the issues in China discussed earlier, business confidence fell sharply in both economies in Q3, dropping by 24pp in New Zealand and 15pp in Australia. Revenue, profitability and export expectations all fell sharply in Australia over the past three months, but New Zealand's business expectations held firm, perhaps because dairy products – which are less affected by China's economic rebalancing – rather than commodities, are the country's main export.

More than two in five business leaders in both economies see upgrading local infrastructure as a key opportunity for the region while a third cite scaling up the Asian Infrastructure Investment Bank. Business leaders in Australia are more hopeful for the TPP (37%) than peers in New Zealand (22%). Businesses in New Zealand, where 30% of businesses are struggling with labour shortages, are more excited by the automation of simple businesses processes, freeing up workers for higher value-add tasks (48%).

The rebalancing of China's economy is of particular concern to Australian businesses (66%), many of which are seeing demand for raw materials dry up as China moves away from investment towards consumption. Businesses in New Zealand are also worried about China (44%) but more so by the general slowdown in demand for natural resources (48%).

Greatest opportunities for the APAC region over the next five years (percentage of businesses)



Source: Grant Thornton IBR 2015

China

China is the largest country on earth in terms of population and economy when measured at PPP. It is the highest scoring economy from emerging APAC in the GDI 2015, ranking 14 overall, but as high as 1 for market growth and 2 for labour market. It also scores well for technology (16) but performance in business operating (48) and financing environments (44=) indicate where development is most needed.

The government is trying to move the economy from a high-growth, export and investment-driven model to a more sustainable, consumption-driven approach. Consequently growth rates have moderated from double digit levels over recent years with current forecasts indicating a steady decline to a more sustainable 5.5% by the end of the decade.

This slowdown in China broadly signalled the end of the commodity supercyle, dampening growth prospects in commodity exporters from Australia to Brazil. And the knock-on effects of recent turmoil on Chinese stockmarkets is another indication of how much more integrated China has become into the global economy.

Business confidence fell sharply in Q3 with fears over the stockmarket and economic slowdown weighing on the outlook for growth. Optimism fell 20pp over the quarter to net 26%, well below the global average of 38%.

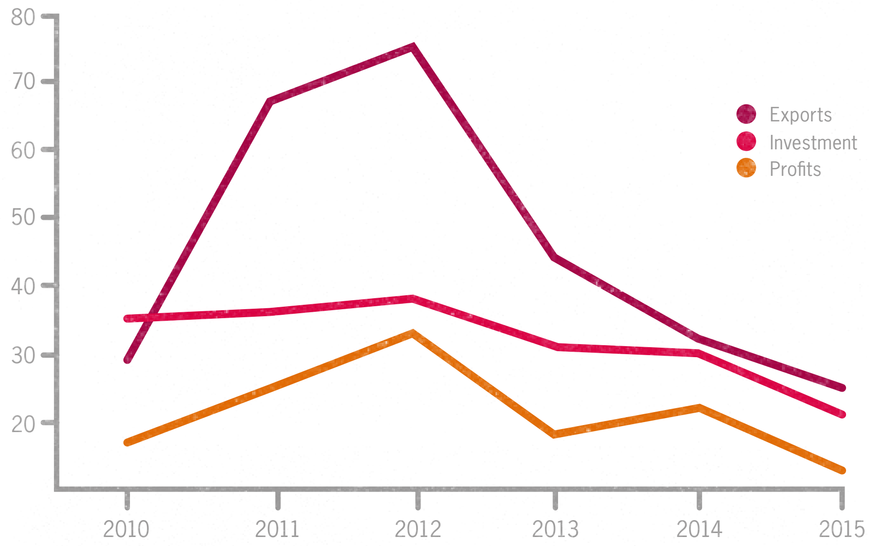
Despite this decline revenue and profitability indicators have held up well over the past three months.

Perhaps of greater concern as China rebalances is that profits seem to be declining along with exports and investment. The leadership is obviously hoping consumption will take up the slack but this does not appear to be feeding through into company bottom lines as yet (see chart).

Growth rates are forecast to decline to around 5.5% by 2020

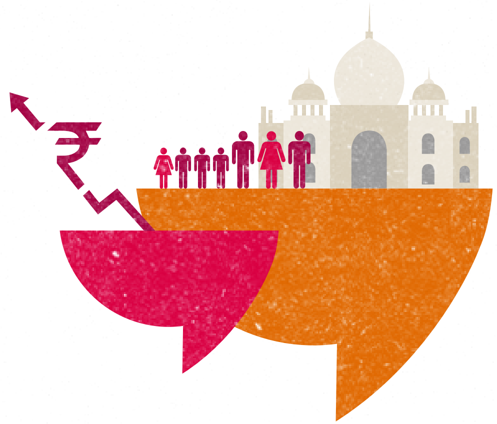
Despite not being part of the negotiations, 30% of Chinese business leaders cite the TPP as the major opportunity for the region. A further 26% cited the new 'Silk Road' initiative. In terms of challenges, 50% cited an ageing population and 32% mentioned that automation could lead to significant job losses.

Net percentage of businesses expected an increase
(next 12 months, Chinese businesses)



Source: Grant Thornton IBR 2015

India



India is the ninth largest economy in the world and home to over 1.2bn people. The economy ranks 34 overall in the GDI – up 14 places from the previous iteration – driven by robust market growth (rank 2) and a dynamic labour market (15). However it ranks 53 for business operating environment, a specific area which the Modi government is trying to address.

India is expected to be the fastest-growing large economy in 2015, overtaking China to expand by 7.5% in 2015, accelerating to 7.7% in 2016. Taming corruption and creating jobs for the millions of young people entering the workforce every year remain central to sustaining these growth rates over the medium to long-term.

The low global oil price (India is a big importer of fuel) has allowed the government to remove subsidies on fuel and actually transition to taxing it. It has also helped pull inflation down from close to double digit rates to 3.7% in August, and offered the Central Bank the space to lower interest rates to further stimulate the economy.

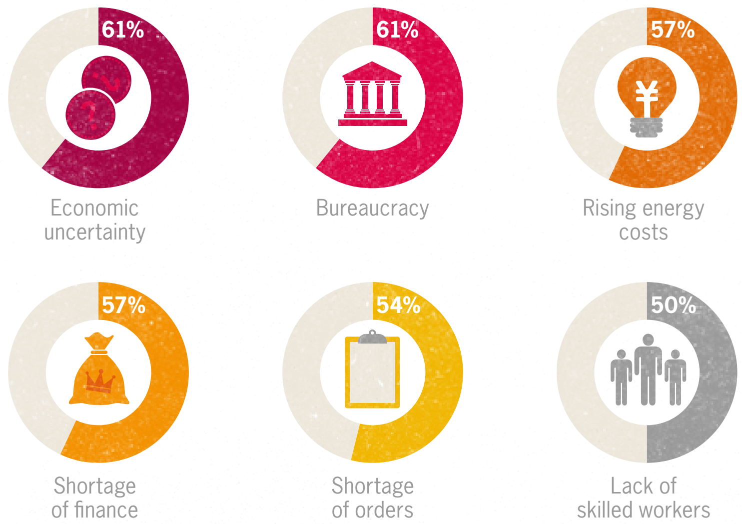
Business confidence remained buoyant in Q3: 87% are optimistic in the economic outlook with only peers in Ireland more positive globally. India is not yet a major trading partner of China so the slowdown and stockmarket turmoil there has had limited impact. Consequently revenue (86%) and profitability (69%) growth expectations remain among the highest globally.

That said, Indian businesses see a lot of challenges to their business growth prospects, principally economic uncertainty and bureaucracy (both 61%). Rising energy costs and shortage of finance (both 57%) are also major concerns.

India's population is booming and 48% of local business leaders see growth in the middle classes as the key opportunity for the region over the next five years, followed by increased ASEAN cooperation (43%) and the globalisation of supply chains (41%).

India has several live border disputes so regional conflict (58%) top the perceived threats while the continuing importance of the monsoon to food supplies means climate change and extreme weather events (48%) are also widely cited.

Percentage of Indian businesses citing factor as a constraint on business growth prospects



Source: Grant Thornton IBR 2015

Japan

Japan is the third largest economy in the world and home to over 127m people. It ranks 36 overall in the GDI, and as high as 5 for technology and 23 for business operating environment. However, it scores very low for market growth (58) and financing environment (57).

Growth rates have disappointed over recent years and remain volatile despite the reform efforts of the government – commonly known as Abenomics – which are trying to boost growth and inflation. Japan is involved in the TTP negotiations with the US and other Pacific Rim countries which have now been concluded despite automotive and dairy sector disagreements.

Corporate governance remains a concern following the Toshiba accounting scandal. Japan also regularly comes bottom of our women in leadership rankings despite Shinzo Abe's ambitious plan to improve the gender balance among the leadership teams of the country's biggest companies whom he has described as the country's most "underused resource".

Business confidence slumped to -28% in Q3, its lowest since Q4-2012. There is some frustration over the slow-burning impact of reforms while turmoil in China, which accounts for 18% of Japan's exports, second only to the US, has dampened optimism. Revenue (down 15 percentage points) and profitability (down 10pp) expectations have fallen over the past three months.

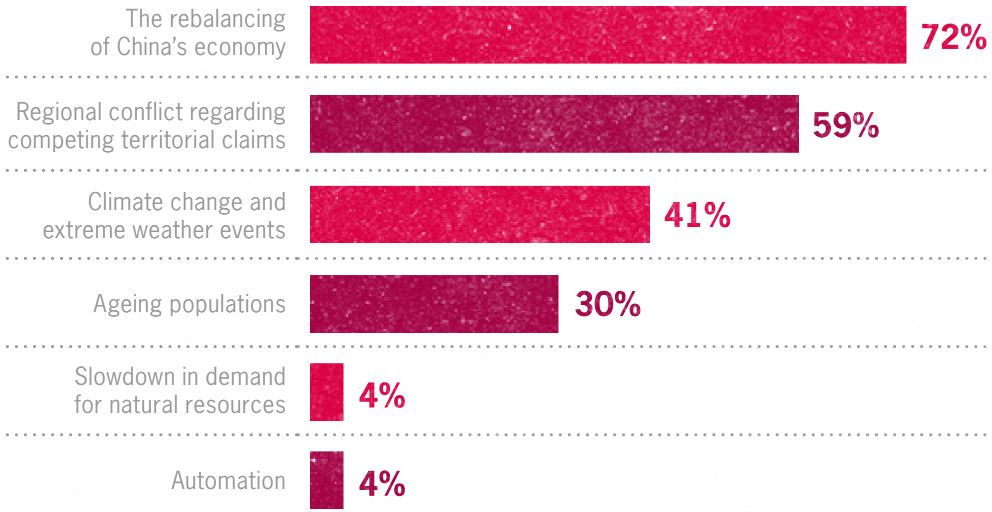
> The TPP is cited by 37% of Japanese businesses as the biggest opportunity for the region over the next five years

Economic uncertainty (69%), low demand (66%), rising energy costs (62%) and a lack of skilled workers (55%) are all cited as major constraints on the ability of Japan's businesses to grow.

The TPP is cited by 37% of Japanese businesses as the biggest opportunity for the region over the next five years. Upgrading local infrastructure (33%) and rapid middle class growth (32%) are also widely cited.

The biggest threats cited both relate to China: 72% cite the rebalancing of its economy and 59% cite regional conflict regarding competing territorial claims.

Greatest threats for the APAC region over the next five years
(percentage of Japanese businesses)



Source: Grant Thornton IBR 2015

About us

Whether you are already working in APAC, or thinking of expanding into the region, our advisers in 20 countries stand ready to help you explore growth opportunities and overcome challenges.

To find out more visit:
www.grantthornton.global/locations

IBR 2015 methodology

The Grant Thornton International Business Report (IBR) is the world's leading mid-market business survey, interviewing approximately 2,500 senior executives every quarter in listed and privately-held businesses all over the world. Launched in 1992 in nine European countries, the report now surveys more than 10,000 businesses leaders in 36 economies on an annual basis, providing insights on the economic and commercial issues affecting companies globally.

The data in this report are drawn from interviews with chief executive officers, managing directors, chairmen and other senior decision-makers from all industry sectors in mid-market businesses. The definition of mid-market varies between countries: for example in China we interview businesses with 100-1000 employees and in Australia those with 100-499 employees. Q3 data is drawn from 2,500+ interviews globally (700 in APAC) conducted in September 2015.

The APAC economies included in IBR are Australia, China, India, Indonesia, Malaysia, Philippines, Singapore, New Zealand and Thailand. Vietnam is included in the GDI but not IBR.

More information is available via: www.grantthornton.global
To access the GDI 2015 report go to: www.grantthornton.global/GDI2015
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