

Start of Transcript

Glenn Maguire: Okay. Thank you very much for joining us for this podcast to discuss the recently released ANZ Research in Depth Report, ASEAN: The Next Horizon. My name is Glenn Maguire and I'm the Chief Economist for South Asia, ASEAN and the Pacific and joining me on the podcast is Tammy Medard, our CEO for ANZ Bank, Lao. To discuss the report, some of the key implications and the evidence of whether we're already seeing these changes we're expecting to see outlined in the report occurring across ASEAN and the Mekong.

The Research in Depth Report ASEAN: The Next Horizon makes four key propositions. The first is that the ASEAN economic community which is scheduled to come into effect from December 2015 will not be a seamless economic community the way the European Union is. There will not be the immediate free flow of goods, of services, of capital and labour across the region; rather it will be a segmented market. Those segments will basically align with the financial depth and the development of each economy. So we expect to see the first segment being the Mekong frontier economies - Myanmar, Cambodia and Lao. These economies are likely to attract the more labour intensive low value added manufacturing in the first instance.

The second segment is what we refer to as the mid-level competing manufacturers - economies like Indonesia, Thailand, Vietnam and the Philippines are going to be competing to attract the mid-level manufacturing segments and eventually move into the higher value added space. Then the final segment will be the high income economies: Singapore, Malaysia and Brunei. Now the fact that we're looking for a segmented rather than an integrated ASEAN region doesn't mean there won't be efficiencies to be sought. This segmentation will allow global value and supply chains enabled by multinational corporations to extend through the ASEAN.

So ASEAN is very much likely to become the key factory Asia in coming decades. We think ASEAN will become as important for the global economy and for Australia and New Zealand as China is now. The key reason for that is the demographic dividend. Whereas the average age of a manufacturing worker in China is now 37, in Japan it's 43 and Taiwan it's 41, in the Mekong that drops to the early 20s and in the ASEAN economies like Indonesia into the early 20s.

So we think it's inevitable that manufacturing platforms are going to drift south from the elderly and expensive North Asian economies into the more youthful and cheaper ASEAN economies, in particular the Mekong economies. Tammy, in your role as CEO for ANZ Bank, Lao are you already starting to see some evidence that this drift in manufacturing platforms is occurring into the ASEAN?

Tammy Medard: Thanks Glenn. Absolutely, I mean we're already seeing companies that started moving perhaps years ago and set up shop in Thailand. But now even in Thailand it's getting more expensive and also recent the coup last year really brought to the attention the geopolitical risk in having all your manufacturing in one country. So what we're seeing is multinational corporates, some of the early movers are Toyota and Nikon are looking across the greater Mekong to really adapt a Thailand plus one model.

So what they're doing is they're looking at Cambodia, Myanmar, Lao. They're attracted to Lao because the cost of electricity is about half that of the average cost across the region. So in Lao they're putting in precision manufacturing and really electricity intense manufacturing. What we're looking at, what we're seeing is in Cambodia where wages are the lowest really across the region, they're putting in the labour intensive manufacturing. They may still be doing the assembly in Thailand but really they're looking to diversify where the final product how it's actually created and different countries that are taking part in that.

Glenn Maguire: One of the things that strikes me about Tammy's point is that the quality of the multinational companies we're seeing moving into the ASEAN and into the Mekong economies is exceptional; it's first tier companies like Toyota and Nikon. This leads us to the second point which we're starting to see development across the ASEAN and that is as these multinational companies shift their production platforms.

You see a change in the frontier Mekong economies and the ASEAN economies from rural employment into urbanised employment and employment that is focused in the export sector. So it starts to create more of a middle class as workers get paid more money you start to see the formation of a middle class and a consuming class across the ASEAN occurring as a result of multinationals shifting their production platforms. That's the second point we make in the report.

The ASEAN is going to rapidly emerge not just as a production hub but as a domestic consumption hub as well. We think given the total size of the ASEAN which will be around

650 million people, the ASEAN will be adding roughly the population of Australia to its consuming class every year. A large and dynamic middle class will coalesce around or within the ASEAN making it a double attractive destination both as a production hub and as a huge domestic market.

One of the evidences we find coming through from our consumer confidence surveys is that optimism particularly in the Mekong economies, Myanmar, Cambodia and Lao are on the outlook in the future is very, very high at these stages. Again Tammy, is that something that you're seeing on the ground in Lao and Mekong? Is there optimism building on the outlook as a result of these developments?

Tammy Medard: Yes definitely. I'd say it's built. So Lao is on the United Nations least developed countries list. So you would think they're the last mover to adopt this optimism but they've moved. So you can go down going to locals' houses that are employed and you might have to pass a rooster or [goat] to get into the house but as soon as you open the doors, you could be anywhere in the world. There's flash appliances, Samsung flat screen TVs hung on the wall.

So really they're seeing the lifestyle that they want to lead on TV and now they have the income to invest in that themselves. Mobile phones I mean you'd be hard pressed finding an iPhone 4. You'd be hard pressed to find anyone that doesn't have the latest Samsung Galaxy or iPhone 5 or 6. They're putting the money into consumer goods.

Glenn Maguire: I guess we both agree on the optimism then from a production perspective and from also a consumption perspective. I definitely agree the connectivity and the tech savvy of the average citizen that you come across in Vietnam, in Lao, in Myanmar is definitely surprisingly high. But I guess one of the impediments which we also touch on in the report is whether this development of factory and consuming Asia within the ASEAN will be hampered by the significant infrastructure deficit across the region. It's estimated that there's a gap of around \$8 trillion in terms of infrastructure across South East Asia which largely is a legacy issue from the Asia crisis of 1997/1998. Governments haven't had the money to invest in public works, in connectivity, and there hasn't really been the access to long term finance.

But we think infrastructure financing is probably going to enter a sweet spot. People are focussed more on the opportunity of the ASEAN. The decline in oil prices is freeing up food

and fuel subsidies and allowing governments to spend more on infrastructure and public works.

And, finally, we have a little bit of competition. It's no longer just the Asia Development Bank who's providing funds for long term financing. We also have the arrival of the China-backed Asia Infrastructure Investment Bank. So I think we could be moving into a period where there's a sweet spot for infrastructure financing, and the connectivity of the ASEAN economies is actually going to pick up. And that will actually help this integration and this flow of multinational companies and production across the Mekong and into the other ASEAN economies.

So I think the infrastructure deficit is going to be something that will probably be resolved a little bit more quickly, but we've had discussions before, Tammy, particularly on the connectivity within the Mekong and the ASEAN economies in particular, with the highway networks. And with Lao being a landlocked economy, what are we seeing with connectivity there? Are multinationals viewing that as an impediment? Or is there perhaps some optimism that the key economic zones are actually going to be located across borders and on networks, and this actually won't be an issue?

Tammy Medard: I mean I think infrastructure in developing nations is always on at least the top three things that need addressing for any developing nation. And that's no different for the greater Mekong.

The greater Mekong has benefited though from development agencies, including the ADB, who invested in the east-west corridor, for example, which is a road that connects Myanmar, Thailand, Cambodia, Vietnam and Laos. So it allows multinational corporates to pick up the pieces along the way, assemble their final product and then, instead of, perhaps, previously just going out into Bangkok port, they now have road access to ports in Vietnam, which is really attractive because, if you look at a map, it's a lot faster to go to China and deliver goods to China, from the Vietnam port, than it is from Myanmar or Bangkok or a Thai-based port.

We're also seeing some more development on the north-south corridor, which is looking to connect Cambodia, Lao and China, and then have offshoots to connect all the greater Mekong countries and more of the ASEAN countries through that.

There is a lot of focus on that, and I think your point is correct with the Chinese Development Bank as well, where I think we're going to see a lot of money poured into

that because that's really going to be crucial at being able to make this whole logistics story work.

Glenn Maguire: I do too, and I think we're already seeing those important developments fall into place. So thank you for taking the time to listen to this podcast. The key aim of it was to share the key economic propositions of it. And I'm so glad that we had Tammy joining us to provide the granularity and the actual examples of what's happening on the ground.

We're definitely excited about the ASEAN economic community and, in particular, the opportunities it's going to provide for the Mekong frontier. And if you would like any more details please feel free to reach out to either myself or Tammy, and we're happy to discuss this exciting development with you further.

So thank you, Tammy, and thank you for listening.

Tammy Medard: Great. Thank you.

End of Transcript