In Southeast Asia This Week

A Chinese naval fleet sailed into the South China Sea February 1 to conduct patrols and training missions. Although show of force exercises are common in the South China Sea, intensifying hostilities between China and Southeast Asian claimants Vietnam and the Philippines raise the implications of military operations in the disputed waters. However, China’s spat with Japan in the East China Sea should constrain blatant Chinese aggression towards its Southeast Asian neighbors.

Thai Pheu Party MPs have requested that Thailand’s Constitutional Court decree whether Democrat Party leader Abhisit should be removed from politics following his expulsion from military service for draft-dodging. The Pheu Thai Party’s efforts to discredit Abhisit in the Constitutional Court could resonate with voters ahead of the March 3 Bangkok mayoral elections.

APEC officials gathered in Jakarta for their first group of policy meetings during Indonesia’s 2013 chairmanship. During the meetings, Indonesia will take the opportunity to inject its own national interest issues in the agenda, but increasingly protectionist trade policies at home are thwarting its diplomatic efforts.

Vietnam is set to finalize restructuring plans for state-owned firms by June this year amid political and economic uncertainties. Reforming the state sector is currently the government and Communist Party’s highest priority.

Southeast Asia Financial Markets

Markets in Southeast Asia continue to prosper into 2013 with the exception of Malaysia where a divided electorate will likely head to the polls in the coming weeks. The region’s high performers, Thailand and the Philippines, continue to lead the region and outperform the MSCI EMI.
Chinese naval fleet enters the South China Sea

A Chinese People’s Liberation Army (PLA) Navy fleet sailed into the South China Sea February 1 for patrol and training exercises. The three ships of the North China Sea Fleet – the missile destroyer Qingdao and the missile frigates Yantai and Yancheng – entered the disputed waters through the Bashi Channel, an international sea route that connects the South China Sea and Pacific Ocean and falls between the Philippines and Taiwan. The Chinese fleet conducted over 20 multi-type combat exercises during the mission, reinforcing its territorial claims, which overlap those of the Philippines, Vietnam, Taiwan, Malaysia and Brunei.

Cascade Asia Analysis
The presence of a Chinese naval fleet in the South China Sea is not alarming in itself. China, the Philippines and Vietnam routinely conduct show of force exercises in the contested seas, often involving regional partners that draw heavier artillery into the equation. But the impact of Chinese war games intensifies when one considers the string of recent developments that have heightened the chance for conflict.

Firstly, the Philippines raised the stakes January 22 by taking China to arbitration through the UN Convention on the Law of the Sea (UNCLOS), of which all South China Sea claimants are signatories. The Philippines’ case doesn’t request the UN tribunal to rule on overlapping territorial disputes, which is outside the purview of UNCLOS. Instead, Manila is challenging the validity of China’s “nine-dash line” claim, and the legal definition of the “islands” over which China declares sovereignty. China, however, has already snubbed the Philippines case, maintaining it will not participate in any arbitral tribunal regarding the South China Sea. Regardless of its legal basis, the UNCLOS arbitration antagonizes China, which has scorned previous attempts to internationalize the issue. Secondly, ASEAN’s failure to reach a consensus on the South China Sea dispute has further marginalized the grouping as a vehicle to resolve the conflict. Without ASEAN as a mediator between claimants, miscalculations and misperceptions may take the place of dialogue and cooperation. Thirdly, Manila continues steps to balance against perceived Chinese bellicose behavior, most recently with the purchase of 12 fighter jets from South Korea on January 30. The Philippines’ concerted effort to shore up strategic alliances and aggressively modernize its military reflects growing disillusion with the direction of diplomacy and negotiations over the South China Sea dispute.

One mitigating development for South China Sea hostilities is the rapidly deteriorating situation between China and Japan over islands in the East China Sea. Skirmishes have come dangerously close to conflict since Japan purchased three islands in the Senkaku/Diaoyus in September 2012. As long as China remains engaged with a much more dangerous naval threat in Japan, we expect China to limit overt antagonisms in the South China Sea that could force its navy to stretch its resources thin.

Bottom Line
China’s naval exercises in the South China Sea reflect shifting momentum away from a diplomatic solution, but riskier tensions in the East China Sea ensure that the Chinese will proceed with caution vis-à-vis the Philippines and Vietnam.

Abhisit’s MP status looms large in run-up to Bangkok mayoral elections

Pheu Thai Party members have submitted a request that House speaker Somsak Kiatsuranont urge the Constitutional Court to rule on the legality of Democrat leader Abhisit Vejjajiva’s MP status. Abhisit was found guilty in November 2012 of draft-dodging in his youth and subsequently stripped of his military appointments and pension in November 2012 by Defense Minister Sukumpol Suwanatat after falsifying documents in order to apply for a teaching job at the Chulachomlao Royal Military Academy. Adhering to parliamentary guidelines, one-tenth of MPs from the ruling Pheu Thai Party signed the request for a decision on whether Abhisit should be removed from politics.

The request is based on precedents set out in Sections 102 (6) and 106 of the Constitution. Under Section 102 (6), an MP cannot maintain their status if they have “been expelled, dismissed or removed from the official service, a state agency or a state enterprise on the ground of dishonest performance of duties or corruption.” Under section 106 (5), an MP’s status is terminated upon “(5) being under any prohibition under section 102.” The Constitutional Court will consider the request following the vetting of the Pheu Thai party MP signatures.

Cascade Asia Analysis
PM Yingluck and the ruling Pheu Thai Party exercise negligible influence over the Constitutional Court where a verdict favoring the ruling party remains in the court’s hand. However, the power struggle in the parliament to disgrace opposition leader Abhisit and his Democrat Party portends for a heated contest for Bangkok’s mayoral position. 25 candidates will contest the March 3 elections for the mayor of Bangkok. Candidates from the Pheu Thai Party and the Democrat Party are currently frontrunners, with both parties vying to distinguish their candidate ahead of March. A recently released Suan Dusit Poll found 41% of respondents supporting Pheu Thai Party candidate Police General Pongsapat Pongcharoen compared to 36 percent backing Democrat Party incumbent and early frontrunner Sukhumbh Paribatra.

Bangkok, traditionally a stronghold of the Democrat Party, would be a lucrative prize for the Pheu Thai Party eager to deepen their political entrenchment. Wooing undecided voters in a sharply divided city is paramount to each party’s electoral success with a Bangkok University poll on January 25 showing 42.1 percent of voters undecided. Casting doubt on Abhisit’s patriotism and the legitimacy of his leadership smears the Democrat Party’s reputation when voters are increasingly frustrated with elite privilege and preferential treatment. In a politically polarized environment, the Pheu Thai Party attacks on Abhisit’s military record and MP status are likely to heighten in the next month.

Bottom Line
The Constitutional Court’s agreement to hear the Abhisit case could have a salient impact on the Bangkok elections favoring the Pheu Thai Party.
Indonesia faces competing internal agendas as APEC meetings begin

Nearly 20 years since hosting and chairing APEC in 1994, Indonesia officially assumed the leadership mantle a second time when initial meetings commenced January 25 in Jakarta. The meetings include various working groups to identify mechanisms to promote resilient growth and a better foundation for economic development in the region, and will help guide discussions in the leadup to the summit in Bali later in October. Indonesia is expected to advance its national interests by promoting investment in infrastructure and ensuring that Indonesia’s exports find overseas buyers.

Cascade Asia Analysis

For the first time during its transition to democracy, Indonesia is projecting a confidence and coherent strategic focus in its foreign policy that have been absent since the Suharto era. A fundamental component of this international outlook appears to be trade and investment with aims to help fuel higher economic growth. By serving as the chairman of APEC this year and hosting the WTO ministerial conference later in December, Indonesia has deftly placed itself on center stage from which it can engage and shape crucial global trade issues.

Indonesia further demonstrated its assertiveness in December 2012 when it nominated former Trade Minister Mari Pangestu (2004-2011) to succeed Pascal Lamy as WTO Director-General in August 2013. Though chances of her nomination appear slim due to unofficial bias toward the next Director-General coming from Latin America as opposed to another appointment from Asia, Ms. Pangestu is lobbying hard for the job and Indonesia is rolling out a full diplomatic effort to support her candidacy.

However, there are deep conflicts between Indonesia’s foreign policy and its trade policy, and until those are reconciled, Indonesia will undermine its economic growth potential. For all of the pro-trade talk by the foreign ministry, the trade ministry is pursuing policies with strong protectionist leanings. Import bans, import licensing and quotas have been installed in a number of industries like agriculture, beef and mining under the current trade minister Gita Wirjawan. The US and Japan have both recently threatened to file an official dispute with the WTO.

Indonesia has also engaged in a crude palm oil (CPO) trade row with Malaysia. Indonesia, the world’s largest producer of palm oil, raised taxes on CPO from 7.5 percent to 9 percent as Malaysia maintains a zero-tariff policy for a second month. The tax increase will only favor Malaysian producers as buyers switch to the lower cost Malaysia option. With increasing frequency, Indonesia is being cast as protecting its domestic market at the cost of free trade.

Bottom Line

Indonesia’s protectionism trade policies will speak louder than its diplomatic pro-trade overtures to the detriment of its domestic industries and international image.

Vietnam sets deadline for restructuring state firms

The Ministry of Finance announced on February 1 a plan to overhaul 52 state-owned enterprises (SOEs) that will be ready by June 2013. According to Deputy Finance Minister Truong Chi Trung, SOEs are to submit their restructuring plans to the ministry for approval and will be required to divest their non-core investments. The government will help resolve bad debt only for companies with good restructuring plans, and will let those with no development prospect go bankrupt. It has also issued a draft decree for public comments that will require SOEs to publicly disclose their financial statements and allow authorities to fire SOE chief executive officials if their enterprises incur losses for two consecutive years or fail to meet earning targets. The draft decree is due to be submitted to Prime Minister Nguyen Tan Dung by March 31. By the end of 2015, the government is expected to retain only 50 to 75 percent of those surviving SOEs, and 100 percent in only a small number of companies in public services, national defense and security.

Cascade Asia Analysis

The state sector is largely seen as responsible for Vietnam’s crippling bad debt. SOEs typically use up half of all government investment and 70 percent of official development assistance, yet produce about 37 percent of gross domestic product. In recent years, spurred by easy access to credit and near monopolies in their sectors, many large SOEs have expanded beyond their core expertise, with non-core investments now making up 12 percent of all SOEs’ registered capital. PetroVietnam, the national upstream oil and gas monopoly, for example, has invested in construction and real estate; while Electricity of Vietnam (EVN), the state electricity monopoly, extended into banking, real estate, and telecoms. The restructuring of state-owned firms will potentially free up lots of business opportunities across the economy for both foreign and domestic investors. As large SOEs begin to sell shares, the stock market will see an increase in initial public offerings this year. Plans to sell stakes in Vietnam Mobile Telecoms Services, the state-owned telecommunications company, and Vietnam Airlines were delayed last year but are expected to proceed in the near future.

Bottom Line

With observers and investors intently watching over their shoulders, the government will clearly need to show signs of progress in coming months.
Central Bank and Monetary Policy

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<th>Central Bank</th>
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<th>CAA Nominal Rate Forecast</th>
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*Cascade Asia estimate
Regional Business Opportunities

Singapore | Telecom | Amount Unspecified

Bidding for 4G spectrum is open
The Infocomm Development Authority (IDA) of Singapore announced the allocation framework for spectrum for 4G telecommunication systems and services. Up for bid is 270 MHz of 4G spectrum, comprising of 150 MHz of spectrum in the 1,800 MHz band and 120 MHz of 2.5 GHz band. Bids will be held in the middle of 2013 and the newly allocated rights will commence on July 1, 2015 for spectrum in the 2.5 GHz band and on April 1, 2017 for spectrum in the 1,800 MHz band. Successful bidders will be required to provide nationwide street level coverage within 12 months for MRT underground stations and road tunnels within 36 months of commencing the new spectrum rights.

Source: Project Finance International

Indonesia | Infrastructure | US$12-15 million

Invites soon for new cruise terminal
Indonesia’s Ministry of Transportation intends to prequalify eligible firms for the development and the commercial operation of the Tanah Ampo Cruise Terminal project located on Bali’s east coast. The planned project will be a public private partnership (PPP) and will entail upgrading to and/or expansion of existing port facilities in Karangasem Regency. If necessary, a new terminal building will be built and the onshore and offshore construction of a modern international cruise terminal and relevant services facilities will be included.

Source: Project Finance International
Southeast Asia Financial Markets

Last year's winners are leading again with Thailand’s and the Philippines’ stock markets up 8.17 percent and 11.32 percent YTD in US dollar terms while the MSCI Emerging Markets Index is up 3.42 percent. Markets are up across the region with selective buying during earnings season on improved global outlook from upbeat corporate earnings in the US, and stronger investor confidence in Eurozone. Malaysia’s KLSE, however, is down 2.4 percent YTD on speculation that Prime Minister Najib Razak will dissolve parliament just after Chinese New Year on February 10th and hold the general election in March. Uncertainties surrounding the election and investor reluctance to take risk amidst upbeat regional prospects could result in high volatility in stock prices. Market jitters will continue until after the elections are held.
Cascade Asia Advisors is a risk assessment and strategic advisory firm focused on Southeast Asia. We combine quantitative and qualitative analysis with rich perspective to render convoluted information into actionable intelligence and uncertain environments into navigable terrain. Our specialized focus is monitoring and assessing what drives political, macroeconomic and financial market developments in frontier and emerging markets in Southeast Asia and how they impact organizations. Our clients find more prosperous market opportunities, modify their business planning with sharper focus and face challenges with greater clarity and confidence. We help organizations understand, adapt and prosper in the Pacific Century.

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