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**REGIONAL
OUTLOOK
Southeast Asia
2009–2010**

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2009–2010**



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PREFACE

Since its inception in 1992, the annual *Regional Outlook* series has offered readers concise and insightful analysis of political and economic trends in Southeast Asia and the wider Asia-Pacific region. Over the course of those sixteen years, *Regional Outlook* has tracked existing political and economic trends, identified new ones and assessed their implications for the Association of Southeast Asian Nations (ASEAN) and its member states. Written in an accessible and easily understood scholarly style, this publication is ideally suited for a modern audience of busy executives, professionals, diplomats, journalists and interested observers. The success of *Regional Outlook* is reflected in the loyal readership successfully built up over the years in Southeast Asia and beyond.

The year 2008 was a landmark year for ASEAN and its commitment to create an ASEAN Community by 2015. Most significantly, the ASEAN Charter was set to come into force in December after Thailand delivered the tenth and final instrument of ratification in November. The Charter will have far-ranging political, economic and social implications in that ASEAN will increasingly become a rules-based organization with its own legal identity. ASEAN's dynamic new Secretary-General, Dr Surin Pitsuwan, has already made good progress in turning the Association's aspirations into reality. In the aftermath of Cyclone Nargis, which devastated large parts of Myanmar, Dr Pitsuwan's unstinting efforts ensured humanitarian relief began reaching cyclone victims, underscoring how ASEAN can be an effective tool in times of crisis. On the domestic front, however, several ASEAN countries had to contend with political instability in 2008, especially Thailand, Malaysia and the Philippines. Political violence continued in southern Thailand,

albeit on a reduced scale, while the failure of an agreement between the Arroyo government and the Moro Islamic Liberation Front was a major blow to peace-building efforts in the Philippines. Unfortunately political instability will continue to challenge several ASEAN members in 2009–2010.

On the economic front, growth will be lower for Southeast Asia in 2009 compared to previous years as a direct consequence of the financial crisis which began in the United States in 2007, worsened considerably in 2008 and then infected the entire global financial system. Even emerging economies have not been spared. Whether the impact of the slowdown of the U.S. and Japanese economies on ASEAN will be mitigated by demand from China and India is now questionable, as both economies are forecast to slow in 2009. Oil and commodity prices fell in the latter part of 2008 and this will ease inflationary pressures in Southeast Asia in 2009. But falling consumer demand in the United States and Japan does not bode well for the region given its dependence on both markets for economic growth. However, barring protectionist measures and future unexpected financial shocks which would further erode global economic confidence, it is expected that the world will ride out the current turmoil in about one to two year's time. Fortunately, leaders at the G-20 and APEC summits in 2008 stressed the importance of maintaining trade openness in the current economic slowdown. Economic integration will continue in the region, especially as the ASEAN Charter enters into force, though the pace may be slightly slower because of the global slowdown.

Regional Outlook 2009–2010 was written by a team of experts from within ISEAS and outside and in this edition several new writers were invited to offer fresh perspectives on future developments in the region. I wish to thank the editors, Ian Storey and Lee Poh Onn, as well as all the writers, for their valuable contributions.

K. Kesavapany
Director
Institute of Southeast Asian Studies

3 December 2008

INTRODUCTION

Two events in the first month of 2008 symbolized the passing of one era in Southeast Asia's political development and the dawning of a new one. On 27 January, former Indonesian President Soeharto died at the age of eighty-six after a long illness. Perhaps more than any other Southeast Asian leader, Soeharto embodied a bygone age. The archetypal strongman had risen to power on the back of an attempted coup by the Indonesian Communist Party on 30 September 1965; at the time, nearby Indochina was wracked by conflict and Southeast Asia itself was riven by Cold War rivalries among the Great Powers. Soeharto ruled Indonesia for thirty-two years, crushing all political opposition but transforming the economic fortunes of the country. His passing was appropriately mourned in Indonesia, though in a country that has transformed itself into a vibrant democracy since the collapse of the New Order in 1998, few looked back with nostalgia at the former strongman's tenure.

Earlier in January, a political transformation of a different kind was taking shape. On the first day of the New Year, Dr Surin Pitsuwan assumed the office of Secretary-General of the Association of Southeast Asian Nations (ASEAN). As he took up his responsibilities, the dynamic former Thai foreign minister did not mince his words, warning that if ASEAN did not reinvent itself it risked marginalization and irrelevance: "Without a strong centre, ASEAN cannot remain the fulcrum of power plays in the region. It cannot remain in the driver's seat in political, economic and security affairs." In order to sit behind that wheel, ASEAN believes it needs a new license, and that new license is the ASEAN Charter. Signed in November 2007 during the Association's 40th anniversary year, the Charter introduces a rules-based framework

designed to realize the aspiration of an ASEAN Community by 2015. During 2008, each of the ten members ratified the Charter, despite opposition by some parliamentarians in Indonesia who were concerned at the efficacy of the Charter, and politicians in the Philippines who argued that ratification should be linked to improvements in Myanmar's human rights situation. The stage seemed set for a new phase in ASEAN's development.

Regional crises quickly tested ASEAN's mettle, with mixed results. In early May, Cyclone Nargis barreled into southern Myanmar, killing more than 100,000 people and leaving millions more homeless. Myanmar's ruling generals had failed to give their subjects adequate warning of the impending catastrophe, and their unwillingness to admit foreign aid workers to help pick up the pieces angered and perplexed the international community. Recognizing that its credibility was on the line, ASEAN stepped in and persuaded the generals to cooperate with foreign donors. The Secretary-General's intervention ensured that outside humanitarian assistance began reaching the victims of the cyclone. ASEAN was deemed to have acquitted itself well.

The second test came in July when tensions erupted on the Thai-Cambodian border over land adjacent to the 11th century cliff-top Hindu temple of Preah Vihear. The flare-up occurred after Thailand's foreign minister had backed Cambodia's bid to designate the temple a UNESCO world heritage site. Thailand's Constitutional Court subsequently ruled the foreign minister's action as unconstitutional, leading both sides to beef up their military forces near the temple. ASEAN's offer to mediate was rejected by Thailand which felt the problem should be resolved bilaterally; Cambodia reacted by threatening to take the issue to the United Nations Security Council. An interim agreement to refer the problem to a joint border commission was hammered out, but tensions flared again in October when a gun battle between Thai and Cambodian forces broke out, leaving several soldiers dead on both sides. The incident not only underscored persistent and deep-rooted suspicions among the ASEAN members, but also the long distance still to travel before the Association could truthfully

declare itself a security community free from the prospect of military confrontation.

Political instability was manifest in other parts of Southeast Asia in 2008, most notably in Malaysia, Thailand and the Philippines, three core members of ASEAN. In Malaysia, elections in March dealt a body blow to the ruling Barisan Nasional (BN) coalition, and especially to the dominant party, the United Malays National Organization (UMNO). For the first time in almost four decades, BN lost its two-thirds majority in the federal parliament, as well as control of five states. The devastating result sealed the political fate of Prime Minister Abdullah Badawi, who subsequently agreed to step down in March 2009 in favour of his deputy Najib Razak. Meanwhile, waiting in the wings was the former deputy prime minister, Anwar Ibrahim, now formal leader of the Malaysian opposition. The deadline he set for the downfall of the BN government through parliamentary defections — 16 September — passed without incident. However, since his re-election to parliament in August, Anwar had quickly established himself as a political force to be reckoned with. In the Philippines, the perceived illegitimacy of the administration of Gloria Macapagal Arroyo, and the weakness of state institutions, resulted in continued and pervasive disillusionment.

Events in Thailand in 2008 took a more worrying and violent turn. The December 2007 elections failed to restore political stability to the country after the ouster of former Prime Minister Thaksin Shinawatra in September 2006 and sixteen months of military rule. The People's Power Party (PPP) — a reincarnation of Thaksin's dissolved political vehicle Thai Rak Thai — won the election and its leader, veteran politician Samak Sundarajev, was appointed premier at the end of January. His appointment sparked demonstrations from the anti-Thaksin People's Alliance for Democracy (PAD) who accused Samak of being a proxy of the ousted prime minister. In August the PAD occupied government buildings in an attempt to force Samak to resign; Samak did resign on 9 September, but only after the Constitutional Court had found him guilty of illegally accepting payments for appearing on a TV cooking show. The PPP replaced Samak with Somchai Wongsawat,

Thaksin's brother-in-law. Violent clashes between the PAD and the police erupted in October, resulting in several deaths. Tensions escalated in November when the PAD laid siege to Bangkok's two main airports, crippling the country's lucrative tourism industry. The occupation ended on 2 December when Prime Minister Somchai resigned after the Constitutional Court dissolved the PPP for electoral fraud. The judgement will do little to resolve the underlying issues that have polarized Thai society.

On the perennial problem of ethnic insurgencies in Southeast Asia, 2008 brought more bad news. The daily catalogue of bombings, shootings and arson attacks continued in Thailand's Muslim-majority southern provinces, raising the body count above 3,700 since January 2004. With the Thai elite preoccupied by the ongoing crisis in Bangkok, the need for a political solution to the problem slipped further down the list of national priorities. In the Philippines, there were cautious grounds for optimism in the first half of the year that a peace deal to end the decades old insurgency in Mindanao was within sight. The government and Moro Islamic Liberation Front (MILF) reached a Memorandum of Agreement (MOA) to create an autonomous homeland in Mindanao, which finally settled the contentious issue of ancestral homelands. However, this optimism was crushed in August with the Supreme Court's ruling that the MOA was unconstitutional. Breakaway factions of the MILF vented their anger by launching attacks against the Philippine armed forces, leaving many dead and displacing more than 120,000 people. The MOA was rendered a dead letter.

As the authors in the Political Outlook section conclude, political instability in Southeast Asia in 2008 is likely to bleed into 2009 and beyond. This is particularly true in Thailand, where further clashes between the PAD and Thaksin loyalists could provoke the armed forces to intervene, setting off a fresh round of political crises. In Malaysia, the focus will be on UMNO's attempts to restore its political legitimacy while trying to fend off an energized opposition under Anwar Ibrahim.

Several countries will conduct, or prepare for, major political events in 2009–2010. Indonesia will hold parliamentary elections in

April, followed by a presidential poll in July. Whatever the results, all signs point to a peaceful electoral process that will further consolidate democracy in Southeast Asia's most populous country. The picture is less rosy in the Philippines, where political maneuvering in the run-up to the 2010 elections could lead to violence. In Vietnam, the ruling communist party will hold a mid-term plenary in early 2009, possibly resulting in leadership changes before the landmark 11th Party Congress in 2011.

Domestic politics aside, Southeast Asia's leaders will be watching with keen interest how the policies of U.S. President Barack Obama impinge upon the region. Given the strong fundamentals in U.S.-ASEAN relations, and Obama's stronger commitment to multilateralism than his immediate predecessor, the outlook for U.S.-ASEAN ties in 2009 is bright.

Dramatic changes in the economic climate in 2008 were beyond anyone's imagination. Warning signs were already present in August 2007 when the subprime mortgage crisis first surfaced, but the scale of the financial crisis that unfolded in 2008 caught everyone by surprise. By the end of the year many economies had already slipped into recession, with more expected to follow suit in 2009. Recovery may occur as early as 2010, but it is unlikely to be a speedy recovery. Financial conditions are likely to remain very difficult for the foreseeable future though one bright note is that inflation looks set to ease in 2009. The price of oil fell significantly in late 2008 and is expected to remain at current levels in 2009, bringing some relief to the economies of Southeast Asia.

The slowdown in the developed economies of the United States, the European Union (EU) and Japan during 2008 will affect the growth trajectory of Southeast Asian economies during the period 2009-2010. By early December 2008, the Euro-zone countries, the United States and Japan were all in recession. As a result, economic growth rates will be much slower in Asia: some economies will have growth rates that thread close to zero, while some will have double digit growth rates reduced to single digits. Emerging economies are expected to provide a source of resilience in this period of global downturn. Eventually,

however, this cannot be expected to continue if major economies do not recover in the latter part of 2009–2010.

In the two years ahead, the growth forecast will remain positive for Brunei Darussalam with rates, however, expected to be below the 2 per cent mark. Lower oil prices do not bode well for the Bruneian economy though its diversification efforts will help to bolster its growth rates during this period of global downturn.

Growth in Cambodia has been nothing short of spectacular in the past few years but this is not expected to continue in 2009–2010: dollarization has limited the capacity of monetary authorities to mop up excess liquidity associated with the asset price boom, and handicapped the implementation of anti-inflationary measures. In a dollarized economy, inflows of capital in the form of dollars automatically increase the money supply, and the capacity of monetary authorities to do anything about it is limited. Rampant corruption remains a major problem in Cambodia requiring urgent attention.

The Indonesian stock market experienced a significant decline in 2008 and uncertainties are expected to last through 2009. The country's export and import sectors will be badly hit during 2009, due to reduced growth among Indonesia's main trading partners and volatile commodity prices. Liquidity constraints and the high cost of financing will be the major challenge facing the domestic economy in 2009. The performance of the economy in 2009 and 2010 depends on a well-functioning financial market, successful elections and the beginnings of a global economic recovery.

In Laos, economic growth is predicted to continue despite the global financial turmoil. The rate of growth will likely be about 8 per cent during 2009–2010, mainly due to the construction of new hydropower and mining projects, and commodity exports. Laos' industrial sector is forecast to continue to grow at double digits. Both the agriculture and service sectors will grow; the former due to increases in foreign direct investment (FDI) and the latter due to an increase in tourism and trade expansion.

Malaysia's banks are well capitalized and have little exposure to the toxic assets responsible for the global crisis. However, as it is

export dependent, its growth prospects will also be negatively affected during this period of downturn. Malaysia's economy should be able to withstand a world recession in 2009, provided that global interest rates continue to decline. In Myanmar, owing to the lack of a conducive business environment, such as increasing government intervention, frequent changes in economic policies, restrictions in foreign trade sectors, private sector controls and the absence of a "level-playing field", growth prospects will continue to be low.

Like its neighbours, the Philippine economy will not be immune from the adverse impact of the global financial crisis. The increasing interdependence of the Philippines with the rest of the world, as seen in the openness of its trade and investment regimes, and increased reliance on international markets, will negatively affect its growth prospects. The same is even truer of Singapore which is the most trade-dependent economy in Southeast Asia. Singapore's growth prospects during 2009–2010 are at risk to due to its considerable linkages to the global economy, especially in areas such as finance and shipping. Nevertheless, the economy has some strong shock absorbers in place: the city-state has significant foreign exchange reserves, banks are well-capitalized and the corporate sector outside of property developers has been conservatively managed resulting in strong balance sheets. Large infrastructural projects, notably the integrated resorts, will also help to shore up growth during the forecast period.

Thailand's economy is forecast to grow at a slower pace in 2009 and 2010 due to decelerated exports and sluggish public investments. The uncertain domestic political situation, budget disbursement, global economic downturn and fluctuating oil prices will hurt the Thai economy during 2009–2010. However, the country's economic fundamentals remain satisfactory with declining inflation, manageable public debt level and ample international reserves.

For Vietnam, economic growth is likely to slow in 2009–2010. FDI inflows and portfolio investment is expected to fall and foreign exchange earnings from exports will also grow more modestly than in previous years. The domestic corporate and banking sectors will struggle in a less benign economic environment, having become bloated in recent

years of rapid growth. Getting the corporate sector on a firmer footing will be a policy priority in 2009–2010.

In sum, Southeast Asia in 2009–2010 faces a host of political and economic challenges that will require a coherent response both from ASEAN as an organization and from the individual member countries.

Ian J. Storey
Lee Poh Onn
Editors

3 December 2008