

# ECONOMIC PULSE

A REPORT ON THE ASIA PACIFIC ECONOMY AND  
ITS IMPACT ON COMMERCIAL REAL ESTATE

## GROWTH MARKETS BEYOND INDIA AND CHINA

INDONESIA, VIETNAM AND PHILIPPINES ARE EMERGING AS ECONOMIC  
CHAMPIONS

The world is preoccupied with the strength of an ostensible global economic recovery and worries about a possible double dip. It is easy to lose sight of the diversity of economic performances across the globe and particularly in Asia in such a scenario.

As the following chart shows, China and India's economy underwent a shallow dip in early 2009 and subsequently reaccelerated towards the end of 2009. Besides the two emerging giants of China and India, three other economies did not suffer a negative y-o-y through the crisis, namely Indonesia, Vietnam and (more precariously) Philippines.

The outperformance of China and India lends credence to the emergence of the BRIC countries. The BRIC (Brazil, Russia, India, China) grouping originally coined by the Goldman Sachs Economics team has gained widespread mindshare and visibility. In its original conception, the BRIC economies were considered to have the potential to become four of the most dominant economies in the world by 2050.

Subsequent to the BRIC coining, the Goldman Sachs Economics team came up with the N-11 (Next 11) grouping. The N-11 economies are Bangladesh, Egypt, Indonesia, Iran, Korea, Mexico, Nigeria, Pakistan, Philippines, Turkey and Vietnam. These economies are not expected to achieve BRIC-like scale and impact, nonetheless, still have the developmental potential to rival smaller G8 economies by 2050.

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Table 1 | CHINA AND INDIA ECONOMY

Japan	1.3	-0.3	-1.4	-4.1	-8.9	-5.8	-5.1
China	13.0	14.0	13.0	12.0	10.6	10.1	9.0
HK	7.3	4.1	1.5	-2.6	-7.8	-3.6	-2.4
Taiwan	6.9	5.4	-0.8	-7.1	-9.1	-6.9	-1.3
South Korea	5.5	4.3	3.1	-3.4	-4.2	-2.2	0.9
Indonesia	6.2	6.4	6.4	5.2	4.4	4.0	4.2
Malaysia	7.4	6.6	4.8	0.1	-6.2	-3.9	-1.2
Philippines	3.9	4.2	4.6	2.9	0.6	0.8	0.8
Singapore	6.7	2.5	0.0	-4.2	-9.5	-3.3	0.6
Thailand	6.4	5.2	2.9	-4.2	-7.1	-4.9	-2.8
Vietnam	7.5	5.8	6.5	5.4	3.1	4.4	5.2
India	8.6	7.8	7.7	5.8	5.8	6.1	7.9

Source: IMA ASIA

Unlike the BRIC, the N-11 group of economies are quite dissimilar. On one end, we have Korea, which by many standards is considered a rich and developed economy and on the other end, we have Pakistan and Bangladesh, both considered to be frontier markets just embarking on their developmental path.

The N-11 grouping, nonetheless, is helpful in crystallizing what we believe to be the often underappreciated growth story in Asia - the triumvirate of Indonesia, Philippines and Vietnam. These three economies were projected by the Goldman Sachs team to be capable of propelling themselves into lower middle-income economies by 2050.

As their economic performance through the global financial crisis shows, this confidence in their potential was not misplaced. In this Economic Pulse we will provide a short summary of what we believe are their structural positives and the consequent potential of their commercial real estate markets.

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Table 2 | INDONESIA

<b>Annual data</b>	<b>2009</b>	<b>Historical averages (%)</b>	<b>2005-09</b>
Population (m)	240.3	Population growth	1.2
GDP (US\$ bn; market exchange rate)	540.3	Real GDP growth	5.6
GDP (US\$ bn; purchasing power parity)	963	Real domestic demand growth	5.3
GDP per head (US\$; market exchange rate)	2,250	Inflation	8.9
GDP per head (US\$; purchasing power parity)	4,010	Current-account balance (% of GDP)	1.5
Exchange rate (av) Rp:US\$	10,390	FDI inflows (% of GDP)	1.7
<b>Major exports 2008</b>	<b>% of total</b>	<b>Major imports 2008</b>	<b>% of total</b>
Oil & gas	23.2	Machinery & electrical equipment	26.0
Fat, edible oil & waxes	11.0	Oil & gas	20.3
Mineral products	10.2	Base metals	11.9
Machinery & electrical equipment	9.9	Chemicals	10.2
<b>Leading markets 2008</b>	<b>% of total</b>	<b>Leading suppliers 2008</b>	<b>% of total</b>
Japan	21.6	Singapore	28.5
Singapore	11.7	China	13.5
US	11.1	Japan	10.7
China	10.1	Malaysia	6.1

Source: EIU

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### Resource Richness

The table on Indonesia's exports shows that a good part of the economy is tied to exports of soft and hard commodities. With a wide array of fossil resources (oil, gas and coal), minerals (tin, nickel and copper), cash crops (rubber, tobacco, sugar, palm oil, hard fiber, coffee, tea and cocoa) and forestry products, there is no doubt that Indonesia is a resource-rich country. A reliance on commodities has the disadvantage of exposure to widely fluctuating commodity prices, particularly as oil & gas exports constitute almost a quarter of its total exports, but the breadth and diversity of Indonesia's natural resources somewhat mitigates this risk. Furthermore, with the rapid economic growth of India and China, there will always be underlying bedrock of demand for commodities of all kinds. While the majority of the economic activity related to resources is carried out in the field, trading or the matching of supply and demand, logistical coordination, management oversight of a geographically sprawling activity are all pieces of his equation that tend to be located in urban areas. This would create significant demand for real estate in major cities, primarily in Jakarta.

### Demographics

While Indonesia, Vietnam and Philippines all have the benefit of a young and growing population that will bring long-term dynamism to their economies, Indonesia stands out by virtue of its population size. At an estimated 230 million, Indonesia's population is more than 2.5 times that of Vietnam (85 million) and Philippines (90 million). It is ranked the fourth most populous country in the world after China, India and the United States. The sheer size of India and China creates domestic markets and makes self reliance a possibility. In the same way, the Indonesian economic locomotive can become an impressive regional growth engine once momentum builds up. As the Indonesian economy expansion incorporates greater numbers of working population, there will be a natural increase in demand of commercial real estate in capital cities like Jakarta.

### Financial Sector still underdeveloped

Indonesia's capital markets are relatively underdeveloped and compel businesses in Indonesia to rely significantly on foreign capital. These foreign sources of capital tend to be flighty, hence subject the businesses to uncertainties that are difficult to manage. At the same time, Indonesia has a relatively high rate of domestic savings which could be better utilized and used to displace foreign sources of capital. This situation clearly suggests significant potential for a robust banking and financial sector to develop in Indonesia which would help to propel the country into its next stage of development. This would have the most significant transformative effect on the commercial real estate markets in Indonesia due to the rapid expansion and high activity multiplier nature of financial firms.

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Table 3 | VIETNAM

<b>Annual data</b>	<b>2009</b>	<b>Historical averages (%)</b>	<b>2005-09</b>
Population (m)	87.0	Population growth	1.0
GDP (US\$ bn; market exchange rate)	89.8	Real GDP growth	7.3
GDP (US\$ bn; purchasing power parity)	256.8	Real domestic demand growth	9.2
GDP per head (US\$; market exchange rate)	1,033	Inflation	10.6
GDP per head (US\$; purchasing power parity)	2,953	Current-account balance (% of GDP)	-5.9
Exchange rate (av) D:US\$	17,800	FDI inflows (% of GDP)	7.5
<b>Major exports 2009</b>	<b>% of total</b>	<b>Major imports 2009</b>	<b>% of total</b>
Textiles & garments	16.1	Machinery, equipment & parts	17.8
Crude oil	10.9	Refined petroleum	9.0
Fisheries products	7.5	Steel	7.8
Footwear	7.2	Materials for textile industry	2.8
<b>Leading markets 2008</b>	<b>% of total</b>	<b>Leading suppliers 2008</b>	<b>% of total</b>
US	19.4	China	20.2
Japan	14.0	Singapore	12.1
China	7.4	South Korea	9.1
Australia	6.9	Thailand	6.3

Source: EIU

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### The natural site for ‘China + 1’ strategy

Despite China’s reputation as the factory for the world, concerns about undertaking manufacturing activities in China are increasing. Rising costs in the coastal cities created by the booming economy has created pressure for low margin manufacturers to explore cheaper locations. One solution would be to move inland to take advantage of the lower costs there. The other would be to look for a similar low-cost and high-skill location in a different country. The advantage of a different country is that it allows diversification of political and economic risks, issues that continue to plague some emerging countries (Table 4).

Vietnam is a natural site for such a China + 1 strategy. Besides a moderately large and young population that has good work ethics, Vietnam possesses a strong command economy which is helpful in urban redevelopment necessary to update and modernize infrastructure. This is by far the country’s most significant advantage over other economies. As the statistics on Vietnam’s exports in 2009 show, with its main exports still a mixture of lower value-added products and natural resources, it is still fairly early for Vietnam’s manufacturing push. We think that as Vietnam starts to capture a larger share of low value-added manufacturing and eventually move up the manufacturing value-add chain, it will broaden and deepen the range of manufacturers in the country. They would, in turn, require management, coordination, engineering and other specialist work which will create a stream of demand for commercial real estate in Vietnam.

Table 4 | PERC RANKINGS

1. Australia	9. Malaysia
2. Singapore	10. China
3. Hong Kong	11. Cambodia
4. Japan	12. Indonesia
5. Macau	13. Philippines
6. Vietnam	14. Thailand
7. Taiwan	15. India
8. South Korea	

*PERC Rankings (Political & Economic Risk Consultancy, Ltd (Risk Outlook 2010, from lowest risk to highest risk)*

*Source: Political & Economic Risk Consultancy*

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Table 5 | PHILIPPINES

Annual data	2008	Historical averages (%)	2004-08
Population (m)	96.1	Population growth	2.1
GDP (US\$ bn; market exchange rate)	167.5	Real GDP growth	5.5
GDP (US\$ bn; purchasing power parity)	318.0	Real domestic demand growth	4.9
GDP per head (US\$; market exchange rate)	1,743	Inflation	6.4
GDP per head (US\$; purchasing power parity)	3,310	Current-account balance (% of GDP)	3.2
Exchange rate (av) P:US\$	44.3	FDI inflows (% of GDP)	1.6
Major exports 2008	US\$ bn	Major imports 2008	US\$ bn
Electronic products	58.1	Electronic parts	16.4
Mineral products	5.1	Telecommunications equipment & electrical machines	14.8
Garments	4.0	Crude petroleum	13.2
Petroleum products	2.5	Food	8.4
Agriculture-based products	2.1	Chemicals	7.1
Leading markets 2008	% of total	Leading suppliers 2008	% of total
US	16.7	US	12.9
Japan	15.7	Japan	11.8
China	11.1	Singapore	10.3
Hong Kong	10.1	Saudi Arabia	8.6
Netherlands	7.5	China	7.6

Source: EIU

**The natural site for 'India+I'?**

While China has captured the manufacturing world's attention, India has carved for itself a formidable reputation as the business process and services off-shoring hub of the world, primarily due to its large number of English speaking and well-educated working population. For broadly similar reasons, Philippines stands out amongst Asian countries as having similar attributes that would attract such BPO services. In a parallel argument to the China+I strategy, Philippines therefore is natural site for a India+I strategy for companies looking to have multiple off-shoring locations to diversify their economic and political risks.

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Business Process Outsourcing (“BPO”) is already a significant contributor to the Philippines economy. It will continue to grow in significance in line with the continued trend towards more off-shoring and job specialization globally. We believe this will be a key factor leading the Philippines commercial real estate markets to develop along similar lines to India, with a particular emphasis on IT/Business Services type facilities.

**The future is bright for the triumvirate**

This economic pulse attempts to sketch a brief argument to persuade the reader that beyond the enormous potential of China and India in Asia, there are other emerging champions. We believe that Indonesia, Vietnam and Philippines in particular deserve the most attention for the reasons cited, and we have barely scratched the surface in our concise description of the structural positives of these three economies.

It is not to say that the path forward for these economies will be smooth and plain sailing, but we believe that their economic fundamentals are strong enough to drive them forward despite the occasional rough seas. Hence, the future is bright for the triumvirate and these are the most interesting growth markets beyond China and India.

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