

RESEARCH



# REALISING THE ASEAN ECONOMIC COMMUNITY IN 2015

Opportunities for occupiers and investors

**Knight Frank**

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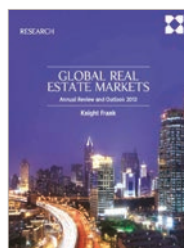
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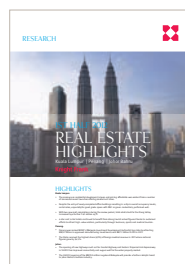
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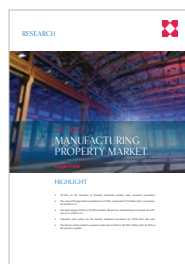
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# INTRODUCTION

## OPPORTUNITIES FOR BUSINESSES AND INVESTORS AS THE STEADY PROGRESS TOWARDS A SINGLE MARKET CONTINUES

**With the ambitious target of implementing the Association of Southeast Asian Nations (ASEAN) Economic Community (AEC) by 2015, the opportunities for corporate occupiers and real estate investors across an enlarged single market of some 600 million people look promising. Nicholas Holt examines the background, the challenges and the possible impacts.**

Nearly five years on from the signing of the AEC blueprint in November 2007, the region is now only three years away from the target of fully implementing measures to create a single market with free movement of goods, services, foreign direct investment and skilled labour.

The possible impacts of actually reaching all of the AEC milestones by 2015 are

significant for member states, Asia Pacific and the world economy. The increasing cooperation of 10 countries that are so divided by language, political, religious, and economic philosophy is impressive. The acceleration of integration which includes the AEC as its focal point will enhance the ASEAN region's emergence as a serious world economic region.

For corporates, the reduced cost of doing business, potential for economies of scale, improved transport infrastructure and a wider labour pool are tangible benefits, whether looking at the region as a manufacturing or service base. For real estate investors, the boost to economic growth, increased transparency and capital markets integration, add to sound underlying fundamentals to provide a compelling story for the region.

In reality, integration as set out in the AEC blueprint is likely to take longer than planned. Protectionism, especially in the form of non-tariff barriers, is an obstacle that will be extremely difficult to eliminate. The lack of central institutions and a reliance on consensus politics are also likely to ensure that the integration exercise will be a more prolonged process. Despite these challenges however, the fast growing, diverse economic landscape of the region will provide a huge range of opportunities over the coming years.



**Nicholas Holt**  
Research Director, Asia Pacific

Figure 1  
**The 10 member states of ASEAN**

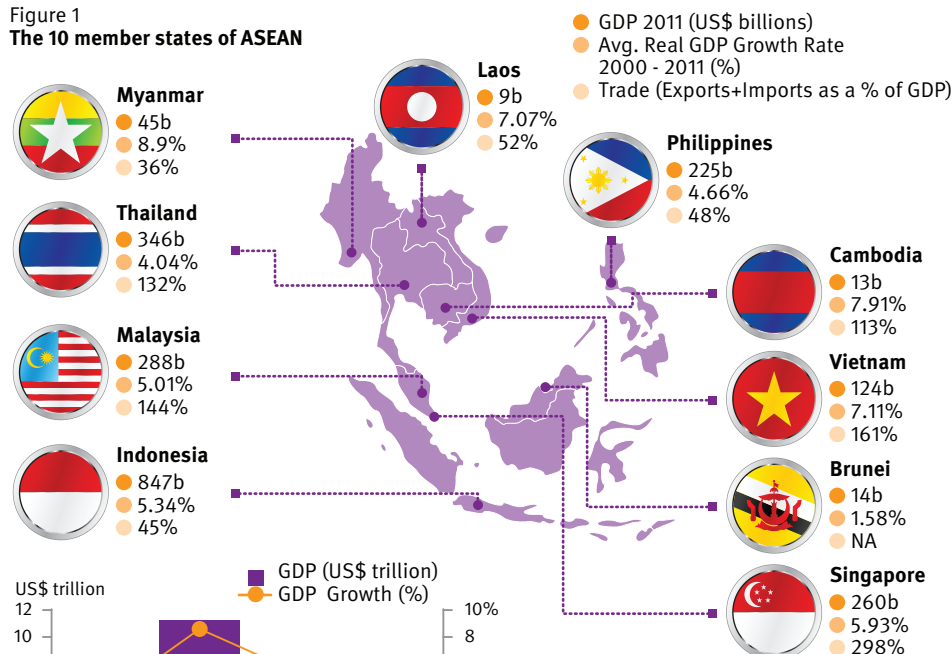
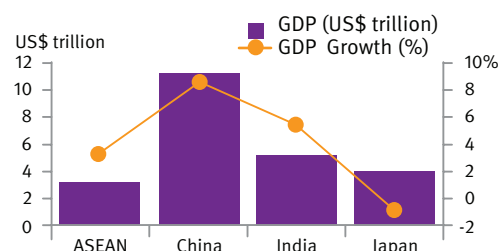


Figure 2  
**GDP (PPP) and GDP growth across the key Asian economies 2011**



Source: EIU, Knight Frank Research (Fig. 1 & 2)

Figure 3  
**Historical timeline of ASEAN**

- 1967** ASEAN declaration signed between Indonesia, Malaysia, Philippines, Singapore and Thailand
- 1984** Brunei becomes sixth member of ASEAN
- 1992** ASEAN Free Trade Area (AFTA) created with Common Effective Preferential Tariff (CEPT), with intra-regional tariffs to be set at a rate of between 0 and 5 percent
- 1995** Vietnam joins ASEAN following the lifting of the trade embargo by the US in 1994
- 1997** Laos and Myanmar join ASEAN
- 1999** Cambodia becomes the 10th and final member
- 2007** The 10 member states agree to implement the ASEAN Economic Community by 2015
- 2015** Planned implementation of ASEAN Economic Community (AEC)

## ASEAN, THE LARGEST REGIONAL INTEGRATION ATTEMPT IN THE DEVELOPING WORLD

**Since its inception in 1967, The Association of South-East Asian Nations (ASEAN), has expanded and now consists of 10 member states, presiding over a population of over 600 million people with a total nominal GDP of USD 2.2 trillion.**

The ASEAN region is increasingly being seen as an important economic pole, with a young urbanising population that is experiencing high economic and population growth. The region provides a spectrum of economies from agricultural-based and low-cost manufacturing to high-end services. Tourism is a growing industry across all its borders. The geo-

political importance of the ASEAN region, situated between the developing market powerhouses of China and India, has added an additional element to the region's attractiveness.

### What is the AEC?

The ASEAN Economic Community (AEC) is the attempt to create a single barrier free market throughout the 10 member countries, without barriers, allowing goods, services, capital and skilled labour to move freely across borders. The key measures are as follows:

- ♦ Removal of intra-regional tariffs

- ♦ Removal of non-tariff barriers (NTB)
- ♦ Free flow of services
- ♦ Free flow of skilled labour (engineers, architects, nursing, medical, dental, accounting, surveying)
- ♦ Integration of capital markets
- ♦ Facilitation of infrastructure development across the region (rail and maritime transport and ASEAN power grid and gas pipelines)

It is important to note that the AEC will not be a customs union, i.e. there will not be a common external tariff system with respect to non-members, although some coordination may be established between member states.

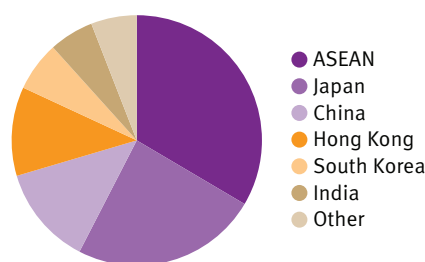
ASEAN's 10 economies vary significantly (see figure 1), with tariffs and NTBs generally lower for the higher income countries. Singapore and Brunei are more open economies, while Laos, Cambodia and Vietnam are much more closed with high levels of protectionism. Due to these differences, the AEC Blueprint allows for a longer time scale to reduce tariffs and NTBs for Cambodia, Laos, Myanmar and Vietnam (by 2015 for many of the measures).

## ASEAN, THE STRATEGIC PARTNER OF THE US?

Both as a destination of investment and as part of its strategic foreign policy within Asia Pacific, the countries within the ASEAN region have been proving increasingly important to the US.

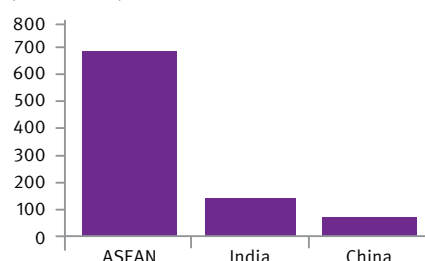
Some would be surprised to know that the ASEAN region receives significantly more foreign direct investment (FDI) from the US than China and India, totalling some US\$21 billion in 2010 (financial outflows). This reflects the attractiveness of a region that provides low cost manufacturing, an emerging consumer class and connectivity to Asia as a whole.

Figure 4  
US FDI into Asia 2010



Source: US Bureau of Economic Analysis

Figure 5  
US ODA into ASEAN, India and China 2010 (US\$million)



Source: US Official Development Assistance Database

It should be noted that China, Japan and the EU (the largest investor) are also investing heavily into the region, with China, the US's great geo-political rival in the region contributing some US\$4.4 billion in FDI in 2010 - as the "courting" of this region has become more competitive between the economic superpowers.

The geopolitical importance of the ASEAN region is also underlined by the US's new foreign policy "pivot" towards Asia Pacific. The ASEAN region spans critical sea lanes and sits between China and India. The US understands the region's strategic importance, shown by the US Official Development Assistance (ODA) statistics for Asia.

*"The AEC Blueprint will transform ASEAN into a single market and production base, a highly competitive economic region, a region of equitable economic development, and a region fully integrated into the global economy."*

ASEAN Economic  
Community Blueprint

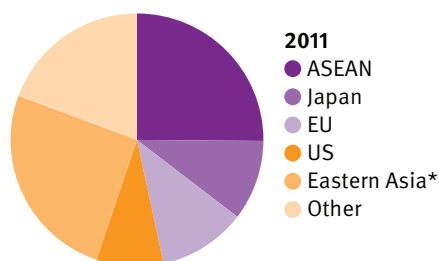
According to the AEC "Scorecard", 67.5% of milestones have been met to date, with the region in the third (2012-2013)

of four phases of implementation. In many ways, the easiest milestones have already been met, as many of the more challenging targets are left until 2015. What will be the impacts if the remaining milestones are (mostly) met by 2015?

### Possible impacts of the AEC

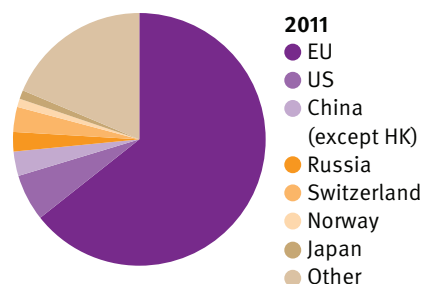
The most obvious impact will be an increase in trade between member countries. In terms of existing trade patterns, intra-regional trade is already significant, making up around a quarter of the region's total trade (see figure 6), but this number only increased slightly between 2000 and 2011 (from 23% to 25%). Policy makers hope that as trade barriers come down, trade will increase significantly between member states. It should be noted that intra-regional trade in the European Union (EU) accounts for over 60% of total trade. The room to grow is therefore significant (see figure 7).

Figure 6  
ASEAN export destinations by country or region



Source: UN Comtrade – 2011 International Trade Statistics Yearbook

Figure 7  
EU export destinations by country or region



Source: Eurostat

\*China, Hong Kong, Macau, South Korea, Mongolia

## INTRA-ASEAN REAL ESTATE INVESTMENT ALREADY SIGNIFICANT AND LIKELY TO GROW

Cross-border real estate investment within the ASEAN region has been concentrated around Singapore, both as the largest recipient of cross-border investment flows in the region, but also as the main investor itself within the ASEAN region. These figures are slightly misleading given the number of institutional investors based out of Singapore (deploying capital originating from throughout the world). However the transparent and liquid Singaporean market has certainly been seen as a relative “safe haven” when compared to some of the additional risks elsewhere.

As the AEC targets are met, the aim of strengthening capital market integration across the region will boost real estate investment, while bilateral tax agreements between all the member states will improve transparency and reduce risk.

As capital is more efficiently allocated across the ASEAN countries, and raising capital across borders becomes easier, we expect investment volumes to increase and pricing to become more straightforward.

The opportunities therefore for intra-ASEAN investors and for external investors looking for exposure into this growing market are significant.

Figure 8  
Origin of cross-border capital flows into ASEAN property 2009 - 2011 (US\$million)

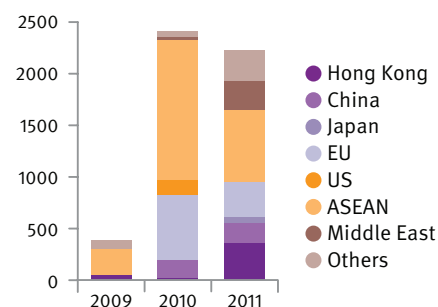
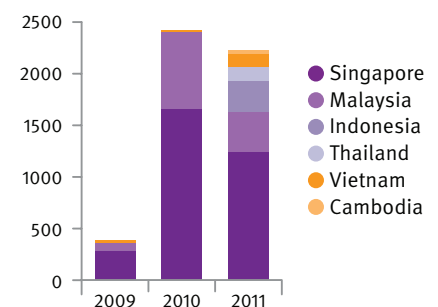


Figure 9  
Destination of cross-border capital into ASEAN property 2009 - 2011



Source: Real Capita Analytics, Knight Frank Research

An increase in intra-regional trade is likely to bring about a number of effects. For firms, it will lower costs as inputs can be imported more cheaply and transportation costs drop as infrastructure is improved. Economies of scale will also be reaped by businesses that can consolidate regional offices and production sites, with easier mobility across markets enabling occupiers to choose the most cost-effective locations. The increase in competition in each market will drive productivity, which will again drive down costs and should be passed on to consumers. The purchasing power of households will increase as they benefit from increased competition,

higher incomes and more imported goods and services. The overall effect will be to boost economic growth, by some estimates as much as 5% across the region (Petri, Plummer and Zhai 2010).

The increase in trade will however accelerate some regional disparities, as goods and services previously produced at high costs within a country, will be replaced by cheaper imports from more competitive markets. The free movement of skilled labour will mean that the countries that have a comparative advantage in goods or services could attract the best talent from around the region.

## And how will this affect commercial real estate markets?

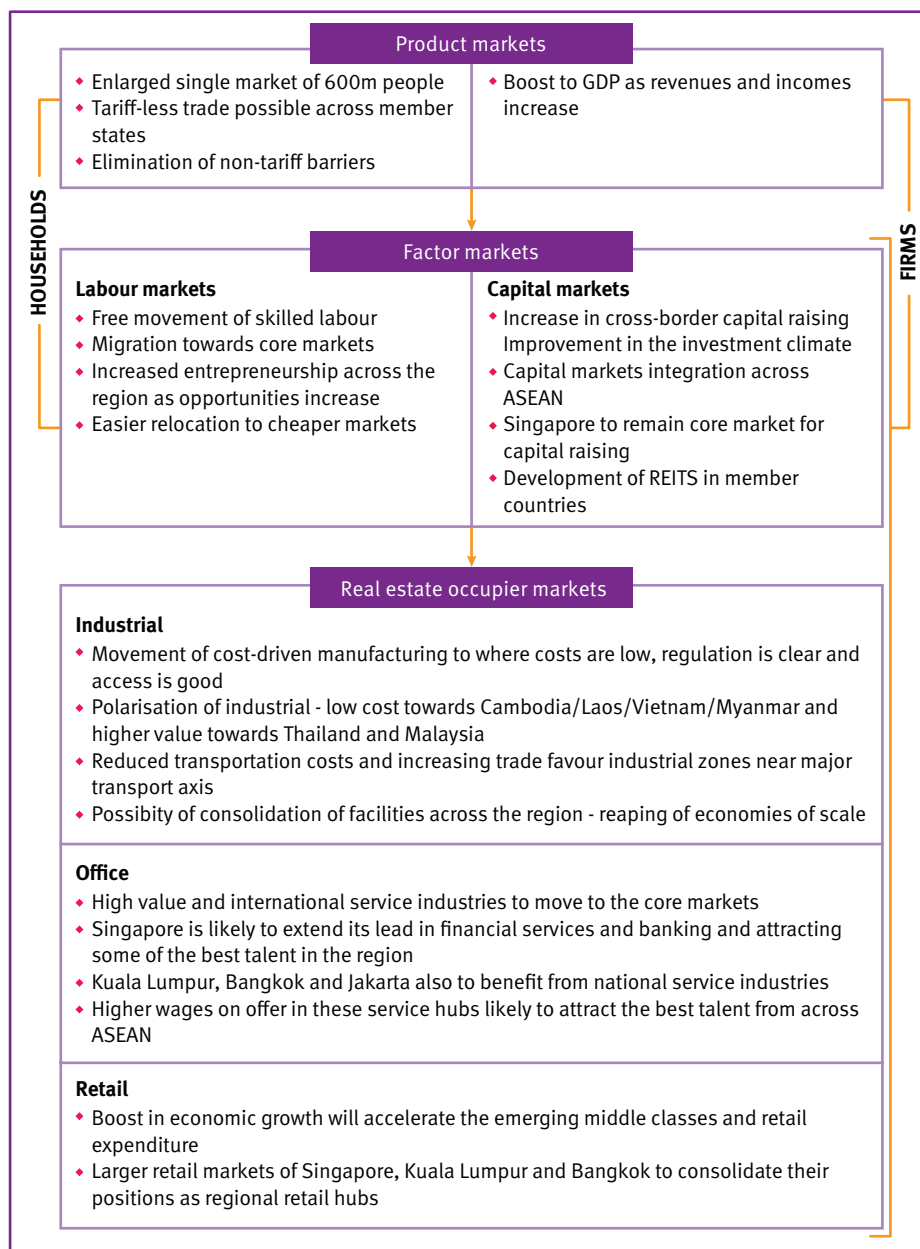
These changes will influence commercial real estate markets whose demand is derived from growth and changes in the economy. With a boost in GDP, there will be a general increase in demand for commercial real estate, as employment growth will be accelerated as production of goods and services increases. The movement of capital and labour towards the strongest markets for each good and service is likely as barriers come down. This could have certain repercussions on the member states and respective real estate markets across ASEAN (see Fig. 8) notably:

- ♦ Singapore to remain and increase its importance as the key financial and high-end service centre for the ASEAN region. As a truly global city with an important stock market, Singapore will act as the key business hub of the region. This will ensure demand for prime office accommodation in the city state remains high.

## Politically ranging from notionally communist to military dominated “democracies” and economically from extremely low to extremely high income per capita, objectives and goals are not the same for each country.

- ♦ Cost-driven manufacturing is likely to move towards markets such as Cambodia, Laos, Myanmar and Vietnam as their physical infrastructure improves. Thailand and Malaysia will have to compete higher up the value chain.

Figure 8  
The possible impacts of the AEC on real estate markets



Source: Knight Frank Research

- ♦ With the continuing increase in incomes and emerging middle classes, retail expenditure will grow significantly, and foreign retailers will be increasingly attracted to an enlarged urbanising single market. Significant urban centres will develop more important retail offerings with foreign goods more prevalent.

## The challenges remain significant

The sheer diversity of countries is probably the largest challenge to the continued integration of the ASEAN countries. Politically ranging from notionally communist to military dominated “democracies” and economically from extremely low to extremely high income per capita, objectives and goals are not the same for each country.





The challenges to increased integration in Southeast Asia are significant. Language, culture, politics, different stages of development, protectionism, non-tariff barriers... These obstacles are not easy to overcome. But despite this, policy makers within the region are successfully pushing for more integration within the framework of the AEC to create an economic bloc that can compete in the global economy.



"Being the largest economy among the member countries and supported by a huge population as well as abundant natural resources, the ASEAN integration (AEC) is considered to be a crucial milestone for Indonesia to generate more opportunities. However, gaps in infrastructure, the lack of human resources and regulatory certainty so far remain the major hold-up of domestic competitiveness to further spur investment climate to a higher level. Varying considerations toward complete liberalization where protectionism still exists in several business sectors of the economy, particularly the service sector, may pose a significant challenge to Indonesia's readiness.

The restriction of foreign individual property ownership is also expected to present another major challenge for the single regional common market preparation as other ASEAN countries impose varying degrees of restriction.



**Willson Kalip**, Country Head, Indonesia

All in all, challenges still remain to achieve the positive goal. Much of the work commitment or breakthrough actions are greatly needed for sustainable growth and it will likely continue beyond 2015."

"10 years of ASEAN membership has allowed Cambodia to strengthen integration with the region and international community. Cambodia has been strictly fulfilling her role in ASEAN to build a prosperous regional community despite some negative impressions of the nation due to its war torn history and its recent border conflicts with Thailand. Cambodia has continued to try and provide a peaceful, stable and pro-investment market to the outside world. The young democratic nation is still small and tends to be dominated by bigger regional powers over its economic sovereignty while the nation has to rely on foreign aid and subsidizing policies of the super powers. Cambodia is still faced with an urgency to improve on transparency and greater



**Sunny Soo**, Country Head, Cambodia

financial accountability to achieve a better business climate for promoting a flourishing SME market, improving on access to finance, expedite the establishment of credit guarantee schemes, and providing a stronger cooperation in policymaking between the government and the private sector."

"Malaysia expects to benefit from improved ASEAN collaboration but remains realistic that large-scale rewards attributed to full integration are still some way off. The Economic Transformation Plan (ETP) that aims to bring about 'high income nation' status to Malaysia by 2020, coincides nicely with many of the 2015 ambitions of the AEC in terms of creating a competitive environment for improving and expanding infrastructure, manufacturing, services and skilled labour. We expect to see Malaysia's industrial sector benefit most from improved ASEAN connectivity (and attract significant FDI inflows) while the Kuala Lumpur retail market looks set to consolidate its place as a top regional shopping destination with knock-on benefits to the hospitality and tourism sectors."



**Sarky Subramaniam**, Executive Director, Malaysia

# KNIGHT FRANK VIEWS WITHIN

Our Knight Frank teams around the world are focused on the awareness of AEC 2015 in the region and the impacts that closer in-



“The ASEAN Economic Community (AEC) aims to achieve free movement of goods, services, investment, skilled labour and freer flow of capital. While fraught with challenges, a successful formation of AEC will be able to achieve significant economic benefits to the region. Singapore is well positioned to become the capital of ASEAN drawing top talents into the country as trade and business volume increase. The potential influx of intra-regional investors will lead to an increase in demand for homes and business spaces directly benefiting the real estate sector. Singapore is ranked first in World Bank’s 2012 Doing Business report comparing over 183 economies, a further testimony of her potential. The outlook of real estate in Singapore looks bright as AEC takes shape in the near future.”



**Png Poh Soon**, Research Director, Singapore

“Although we expect implementation of the policies to face some initial teething problems, the Government has publicly stated their intention to improve trade relations with regional members. Vietnam is a developing country that suffers from a lack of transparency, corruption and complicated legal and ownership structures (red tape). In the past, this has hindered FDI growth for the local economy as many international companies investing in real estate, manufacturing,

import/export sectors etc, have been discouraged and have sought alternative options in the region. Registered FDI capital in Vietnam peaked in 2008 at US\$71.7 billion on the back of a booming real estate and stock market, decreasing every year since to US\$14.7 billion in 2011. The unofficial announcement of the appointment of Vietnam’s Vice Foreign Minister Le Luong Minh as ASEAN Secretary General for 2013 for a five-year non-renewable term will further strengthen the country’s commitment to adhere to the ASEAN objectives and guidelines for 2015 onwards. While current real estate conditions remain challenging in most segments, we anticipate membership of the AEC will provide a much needed boost for the market”



**Stephen Wyatt**, Country Head, Vietnam

# FRANK'S FROM ASEAN

the ASEAN region comment  
their respective countries  
integration could bring.

“Last year Thailand’s biggest export destination (24%) and its second biggest supplier (after Japan) was ASEAN itself, and as the ASEAN economies continue to mature, and the inter-industry linkages deepen, the opportunities should grow too. Planned investment and improvements in logistical linkages with the member states of the AEC should reduce the transportation costs of goods and raw materials, boosting Thai competitiveness. But this will take time, and while minimising cost is important, from a manufacturer’s perspective, the depth of capability and market access when taken together are given just as much weight, in a firm’s decision making analysis. It is here that Thailand competes today, and not just with its ASEAN neighbours but on the world stage against such countries as China.

To attract more manufacturing FDI after 2015, the challenge for Thailand will be the same as it faces today: to compete higher up the value chain by implementing well thought out policies designed to upgrade the industrial infrastructure and human capital.

Further liberalization of Thailand’s service sector should present many opportunities for service providers with a regional presence to open a base here to not only take advantage of the opportunities present in ASEAN’s second largest economy (Thailand) but also of the geographic advantages that the country offers through its borders to Cambodia, Laos, Myanmar and Vietnam.”



**Marcus Burtenshaw**, Director, Thailand

Due to the divergence of political regimes, there has been reluctance in giving up any power to the supra-regional which has manifested itself in the absence of strong centralised institutions. So far very little money has been put into creating the institutions which will be necessary for enforcement and to ensure compliance. The ASEAN model has been based around consensus politics, which will fall short if a member state is not complying with the measures set out in the blueprint.

Ongoing protectionism in the form of non-tariff barriers to entry is likely to continue to be a major stumbling block towards a single market. Non-tariff barriers are difficult to define and more difficult to reduce. Across the region, state ownership of large industry is commonplace, and continued preferential treatment of these state-owned businesses, including the blocking of foreign competition could prove to be a significant barrier which will take much longer to overcome.

Indeed, while leaders are even looking beyond the AEC, with initial discussions for an ASEAN + 6 (Australia, China, India, Japan, Korea, New Zealand) free trade agreement pencilled in for November, protectionism within ASEAN itself will need to be tackled before looking at a wider arrangement.

## Lessons from Europe

In many ways the AEC blueprint can draw parallels to the Treaty of Rome in 1957, which led to the forming of the European Economic Community (EEC), the predecessor of the European Union. The six nations that founded the EEC however were politically, socially and economically on a very similar footing, something that cannot be said about the ASEAN countries. The difficulties for the ASEAN countries, at such different stages of development and with different political ideologies cannot be overstated.

In general, language and cultural factors have restricted intra-regional labour migration within Europe, although during the first 15 years, the Italians, the poorest of the original six, and after 2004, the

Eastern Europeans proved to be the largest economic migrants around the region. In contrast, the AEC sets limits on free labour movement to an explicit list of skilled labour and this is likely to benefit the major economic hubs of Singapore, Kuala Lumpur, Bangkok and Jakarta. Indeed we could see a “London effect” in Singapore where the brightest and most talented gravitate towards the financial, banking and legal industries.

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**The ASEAN region has much further to go, but in many ways more to gain than the EEC did in 1957. The parallels with the EU are interesting and should be used as a lesson both in how to achieve a single market but also how to avoid potential mistakes further down the line.**

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Today, although the mood within Europe has undoubtedly turned sour, the huge benefits that the single market has provided to its member states should not be forgotten. ASEAN leaders certainly seem to be taking note of where the Eurozone has gone wrong, namely not to straightjacket countries into monetary union without fiscal union.

In terms of real estate, the EU is a much more integrated, transparent market, with high levels of intra-regional capital flows. The ease of doing business cross-borders has led to consolidation and centralisation, with various geographical regions benefiting from different industries.

The ASEAN region has much further to go, but in many ways more to gain than the EEC did in 1957. The parallels with the EU are interesting and should be used as a lesson both in how to achieve a single

market but also how to avoid potential mistakes further down the line.

## Conclusion

The challenges to increased integration in Southeast Asia are significant. Language, culture, politics, different stages of development, protectionism, non-tariff barriers... These obstacles are not easy to overcome. But despite this, policy makers within the region are successfully pushing for more integration within the framework of the AEC to create an economic bloc that can compete in the global economy. The concern however, is that without the necessary institutions to enforce cooperation, any ambitions for further integration are only as good as each country's willingness to take these steps. Protectionism is the obvious issue, and the reality is that a 2015 deadline to meet all of the AEC milestones is extremely ambitious. In all likelihood, only the foundations of a single market are being laid and although we certainly see a more open market for goods in the region, the truly free movement of services and capital is likely to take longer to implement.

The wide economic base, with strong economic growth and a young urbanising population is already proving attractive however, with the region attracting large amounts of FDI from all around the world. And the prospect of a larger single market, with increased trade and cooperation is exciting for businesses and occupiers who are looking at the region either through the lens of a product or factor market.

The dynamics of the real estate markets are likely to continue to change as the ASEAN market does become more integrated. This will provide an opportunity for real estate investors both from within ASEAN and external non-members as the growth story of the region is enhanced, markets become more transparent and investment risks are mitigated.



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