

Supply Chain Diversification: Future Opportunities in ASEAN Market

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- While the “China + 1” strategy is not new, the increasingly protectionist stance of the US and European Union against China makes it worthwhile to revisit its current status and explore new opportunities within the global supply chain that could benefit from this strategy.
- Association of Southeast Asian Nations (ASEAN) countries have received significant foreign direct investment (FDI) and gained market share in the textile & garment, electrical & electronics, and automotive industries over the past years.
- Future investment opportunities could arise as semiconductor manufacturers in the region move up the value chain. The pharmaceutical industry and renewables could also gain traction by leveraging the strong manufacturing foundation.
- However, supply chain diversification could become less effective given China’s growing economic influence in the ASEAN region and could expose global firms to a new set of risks.

Since 2018, the Sino-US trade disputes sparked the rise of the “China + 1” strategy, where businesses diversify supply chains by maintaining operations in China while expanding into other markets. The COVID-19 pandemic and the Russo-Ukrainian War have highlighted the risks of relying on a single market, making the “China + 1” strategy essential for global business planning. With the US election approaching, both Kamala Harris and former President Trump have demonstrated protectionist stances against China. Trump has been vocal about a 60% tariff on Chinese goods, while Harris has pledged to continue the Biden administration’s trade policies. Given this backdrop, global companies are likely to keep investing in ASEAN countries to ensure supply chain resilience. Therefore, it is timely to revisit the current status of the “China + 1” strategy and explore new opportunities within the global supply chain.

Chart 1: Foreign Direct Investment of ASEAN Countries (excluding Singapore) 2018 – 2023

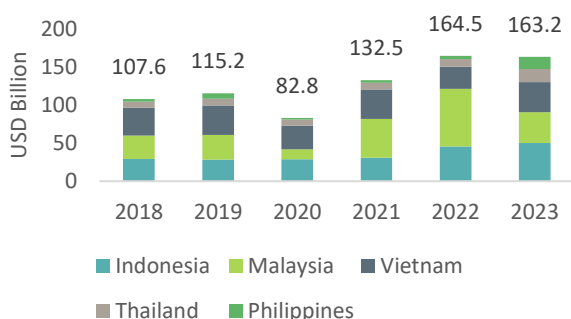
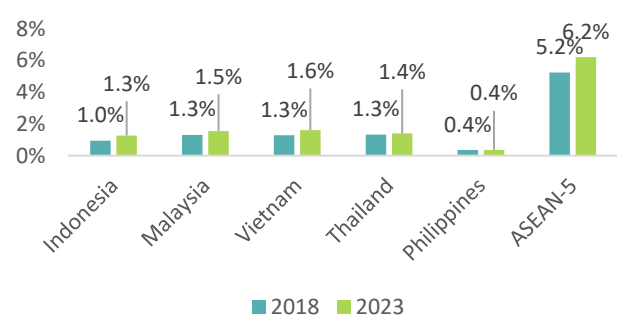


Chart 2: ASEAN Countries (excluding Singapore) Export as % of Global Total Export



Sources: BPS-Statistics Indonesia, as of December 31, 2023. Malaysia's National Statistics Organisation, as of December 31, 2023. Ministry of Planning and Investment of the Socialist Republic of Vietnam, as of December 31, 2023. The Board of Investment of Thailand, as of December 31, 2023. Philippine Statistics Authority, as of December 31, 2023.

Source: UN Comtrade, as of December 31, 2023

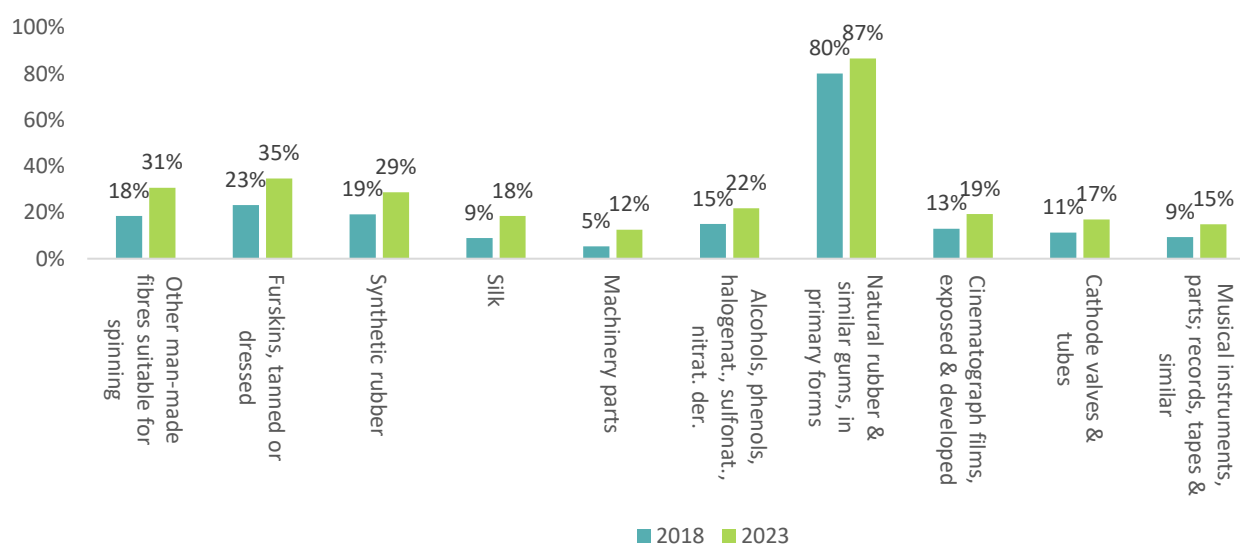
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Where are we now?

Since the US-China trade disputes began six years ago, there has been a surge in foreign direct investment (FDI) in ASEAN countries, particularly in Indonesia, Malaysia, and Vietnam. The ASEAN share of the global export market increased from 5.2% in 2018 to 6.2% in 2023. Although this gain appears modest, global companies have leveraged the unique advantages of each country to enhance supply chain resilience. Consequently, several competitive manufacturing hubs have emerged in the region, gaining significant market share in the global export market.

Vietnam, for example, has made substantial gains in the textile and electronics parts production sectors. Complementing this growth, the Vietnamese government's transport infrastructure master plan aims to build 5,000 km of new expressways, high-speed rail routes, deep-water ports, and new international airport.¹ These developments are poised to significantly enhance the country's transportation capacity, supporting its ambition to become a regional manufacturing hub. Malaysia has become a leading hub for semiconductor manufacturing, attracting substantial FDI from major firms like Intel and Micron. According to HSBC Global Research, electronics have driven significant investment into Malaysia since the pandemic, accounting for 64% of Malaysia's total manufacturing FDI in 2023.² As a result, Malaysia's export share of integrated circuits and parts increased from 6.7% in 2018 to 10.2% in 2023. Indonesia, leveraging its rich nickel resources—a key component of electric vehicle (EV) battery production—is gradually becoming an integrated hub for EV manufacturing through its commodity down-streaming policy. While FDI into Thailand and the Philippines is comparatively lower, they have seen varying degrees of market share gains in the textile, electrical and electronics, and automotive industries in the global export market.

Chart 3: Top 10 Merchandise Product Type (excl. primary industry) by Standard International Trade 3 Digit Classification (SITC) that ASEAN Countries (excl. Singapore) has Gained the Most Market Share in the Global Export Market from 2018 – 2023



Source: UN Comtrade, as of December 31, 2023.

¹ Source: Vietnam Transport Infrastructure: State, Challenges & Future, October 2024. <https://www.vietnam-briefing.com/>.

² Source: Healthy FDI inflows key, April 8, 2024. Malaysian Investment Development Authority. <https://www.mida.gov.my/>

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What could be the next supply chain shift?

With the US and European Union likely to adopt more protectionist stances against China, a further shift in supply chains from China to ASEAN economies is expected. Identifying industries that could benefit from the “China + 1” strategy is crucial for uncovering early investment opportunities. The Revealed Comparative Advantage (RCA) index can indicate a country’s competitive export strengths. Analyzing the RCA index helps identify industries where both China and various ASEAN countries have overlapping strengths, representing potential supply chain relocation opportunities.

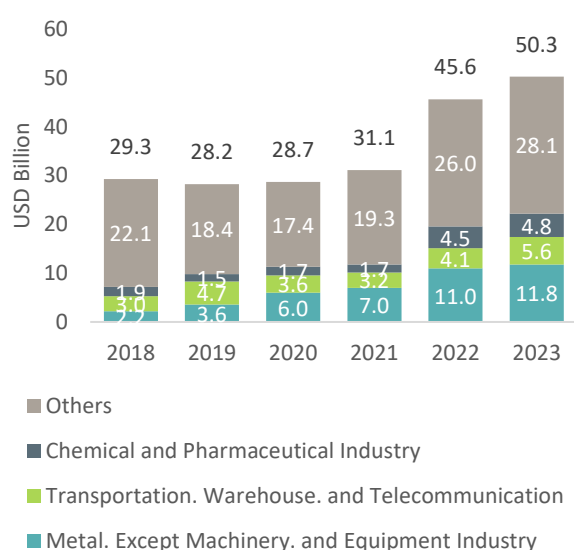
Unsurprisingly, most sectors where ASEAN economies have overlapping RCA with China are in textiles and garments, electronics, and home appliances, due to lower labor costs and a relatively skilled, young workforce. Although significant investments have been made in these sectors, FDI is expected to continue, with potential for further export share gains. Future investment opportunities are likely to emerge around these sectors with established competitive advantages.

For example, Malaysia has leveraged its leading position in semiconductor assembly, testing, and packaging by setting up its first chip design hub in Selangor in August 2024, aiming to move up the value chain. The country has capitalized on the proliferation of cloud computing and the growth of the Internet of Things (IoT) to establish itself as a data center powerhouse. According to HSBC estimates, data center supply in Malaysia could reach 4.1 gigawatts (GW) by 2030, the highest among ASEAN countries.

The strong manufacturing base in the region could also boost the pharmaceutical industry, both in drugs and medical equipment, as global firms address the rapidly growing domestic market due to favorable demographics. Within the region, Singapore is a well-established innovation hub. While other markets are relatively more nascent, Indonesia is increasingly seen as a key manufacturing hub for pharmaceutical products. A surge in investment has been witnessed, with global drugmakers such as Novo Nordisk partnering with local pharmaceutical companies to package pharmaceutical goods in the country.³

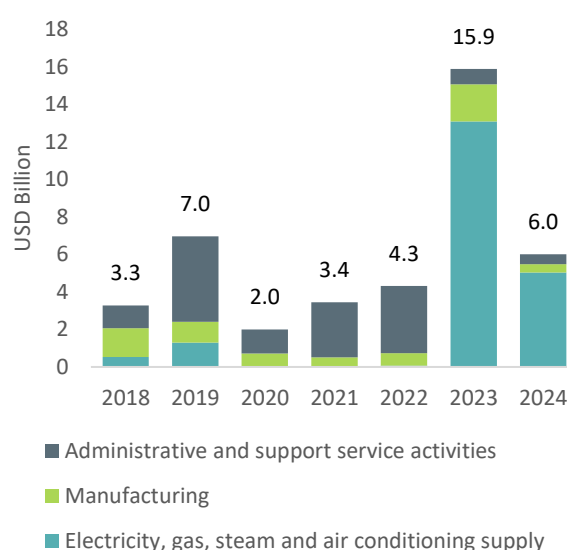
Renewable energy, such as solar photovoltaic (PV) and its components, could gain traction due to supply chain synergies with the region’s established electronics industry (e.g., inverters and control systems). In fact, there has been a surge of FDI in renewable energy in the Philippines, with investors from China and Switzerland, after the country started to allow 100% foreign ownership in renewable energy projects since 2022.

Chart 4: Indonesia FDI by Sector 2018 – 2023



Source: BPS-Statistics Indonesia, as of December 31, 2023.

Chart 5: Philippines FDI by Sector 2018 – 2023



Source: Philippine Statistics Authority, as of September 30, 2024.

³ Source: Indonesia Strengthens Pharma Sector with Novo Nordisk Partnership, July 25, 2024. <https://www.aseanbriefing.com/>.

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Another Set of Risks

While the “China + 1” strategy aims to mitigate risks associated with over-reliance on China, it could expose companies to additional operational risks. Global firms must navigate the heightened complexity of supply chains across different jurisdictions. Furthermore, China’s economic influence in ASEAN has consistently increased over the last decade, as evidenced by the higher share of FDI and trade value in ASEAN countries. This growing influence has enhanced ASEAN’s integration into regional and global markets but could also make the region more susceptible to China-related risks, potentially undermining the benefits of supply chain diversification in the future.

Nevertheless, with rising geopolitical tensions globally, ASEAN countries are likely to continue attracting FDI, representing significant investment opportunities. It is understandable that most investors are not yet heavily invested in ASEAN markets due to concerns about market size, liquidity, and currency risks. Additionally, investing in growth sectors within the secondary market is challenging, as a significant portion of ASEAN market capitalization is concentrated in banks. However, banks could be a good proxy for regional economic growth and appear to be well-positioned to potentially be a key beneficiary of sustained FDI inflows.

Chart 6: China FDI as % of total ASEAN FDI 2018 – 2022

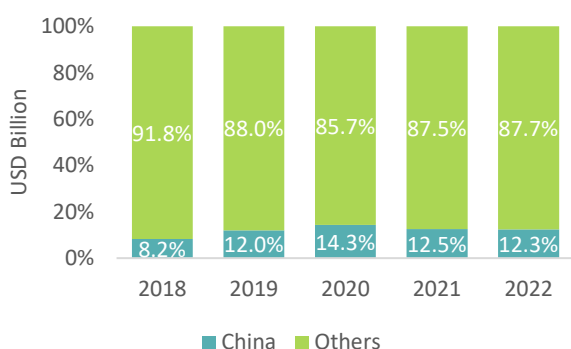
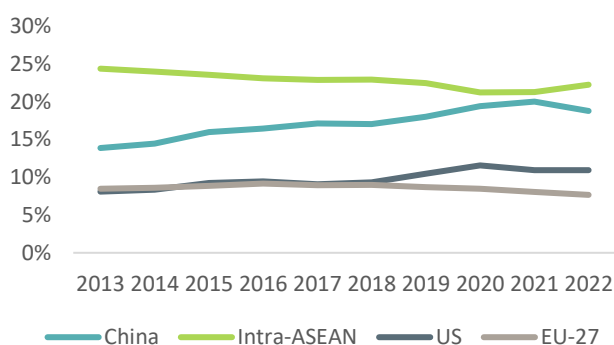


Chart 7: Share of ASEAN’s Total Trade Value



Source: Association of Southeast Asian Nations, as of December 31, 2023.

Glossary

Protectionism refers to government policies that restrict international trade to help domestic industries.

Foreign direct investment (FDI) is a category of cross-border investment in which an investor resident in one economy establishes a lasting interest in and a significant degree of influence over an enterprise resident in another economy.

Commodity down-streaming is an economic policy proposed in Indonesia to prioritize development of commodity downstream processing industries

Cloud computing is the on-demand availability of computer system resources, especially data storage (cloud storage) and computing power, without direct active management by the user.

The Internet of Things (IoT) describes the network of physical objects—“things”—that are embedded with sensors, software, and other technologies for the purpose of connecting and exchanging data with other devices and systems over the internet.

Solar photovoltaic is a system to generate electricity from sunlight

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Appendix

Table 1: List of Products (excluding primary goods) which China and ASEAN Countries (excluding Singapore) have Overlapping Revealed Comparative Advantage (RCA > 1)

	SITC 3 Digit Category	Indonesia	Malaysia	Philippines	Thailand	Vietnam
Chemical	Nitrogen-function compounds	No	No	No	No	No
	Carboxylic acids, anhydrides, halides, per.; derivati.	Yes	Yes	No	Yes	No
	Inorganic chemical elements, oxides & halogen salts	Yes	No	No	No	No
Textile & Garment	Fabrics, woven, of man-made fabrics	Yes	No	No	No	No
	Knitted or crocheted fabrics, n.e.s.	No	No	No	No	Yes
	Silk	No	No	No	No	Yes
	Made-up articles, of textile materials, n.e.s.	No	No	No	No	Yes
	Cotton fabrics, woven	No	No	No	Yes	No
	Tulles, trimmings, lace, ribbons & other small wares	No	No	No	Yes	No
	Clothing accessories, of textile fabrics	No	No	No	No	Yes
	Women's clothing, of textile, knitted or crocheted	Yes	No	No	No	Yes
	Articles of apparel, clothing access., excluding textile	Yes	Yes	No	Yes	Yes
	Footwear	Yes	No	No	No	Yes
	Manufactures of leather, n.e.s.; saddlery & harness	No	No	No	Yes	Yes
	Women's clothing, of textile fabrics	Yes	No	No	No	Yes
	Special yarn, special textile fabrics & related	No	No	No	Yes	Yes
	Men's or boy's clothing, of textile, knitted, croche.	Yes	No	No	No	Yes
	Textile yarn	Yes	No	No	No	Yes
	Articles of apparel, of textile fabrics, n.e.s.	Yes	No	No	No	Yes
	Men's clothing of textile fabrics, not knitted	Yes	No	No	No	Yes
	Synthetic fibres suitable for spinning	Yes	Yes	No	Yes	Yes
	Other man-made fibres suitable for spinning	Yes	No	No	Yes	No
	Furskins, tanned or dressed, excluding those of 8483	No	Yes	No	Yes	No
Electronics	Automatic data processing machines, n.e.s.	No	Yes	Yes	Yes	Yes
	Telecommunication equipment, n.e.s.; & parts, n.e.s.	No	Yes	No	No	Yes
	Electrical machinery & apparatus, n.e.s.	No	Yes	Yes	No	No
	Office machines	No	No	Yes	Yes	Yes
	Sound recorders or reproducers	No	No	No	Yes	Yes
	Electric power machinery, and parts thereof	No	No	Yes	Yes	Yes
	Textile & leather machinery, & parts thereof, n.e.s.	No	No	No	Yes	Yes
	Photographic apparatus & equipment, n.e.s.	No	No	Yes	Yes	Yes
	Heating & cooling equipment & parts thereof, n.e.s.	No	No	No	Yes	No
	Parts, accessories for machines of groups 751, 752	No	Yes	Yes	Yes	Yes
	Rotating electric plant & parts thereof, n.e.s.	No	No	No	No	Yes
	Apparatus for electrical circuits; board, panels	No	Yes	Yes	Yes	No
	Equipment for distributing electricity, n.e.s.	No	No	Yes	No	Yes
	Cathode valves & tubes	No	Yes	Yes	No	Yes
	Meters & counters, n.e.s.	No	Yes	Yes	No	Yes
Furniture	Furniture & parts	Yes	No	No	No	Yes
Home Appliances	Household equipment of base metal, n.e.s.	No	No	No	Yes	No
	Cutlery	No	No	No	No	Yes
	Household type equipment, electrical or not, n.e.s.	No	No	No	Yes	No
	Television receivers, whether or not combined	Yes	Yes	Yes	Yes	Yes
	Radio-broadcast receivers, whether or not combined	No	Yes	Yes	Yes	No
Industrial	Vapour generating boilers, auxiliary plant; parts	No	No	No	No	Yes
	Flat-rolled prod., iron, non-alloy steel, coated, clad	No	No	No	No	Yes
	Wire of iron or steel	No	Yes	No	No	Yes

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	Pumps (excluding liquid), gas compressors & fans; centr.	No	No	No	Yes	No
	Ball or roller bearings	No	No	No	Yes	No
	Machine-tools working by removing material	No	No	No	Yes	No
Materials	Glassware	No	No	No	No	Yes
	Articles, n.e.s., of plastics	No	No	No	Yes	Yes
	Glass	No	Yes	No	No	No
	Manufactures of base metal, n.e.s.	No	No	No	Yes	No
	Rubber tyres, tyre treads or flaps & inner tubes	Yes	No	No	Yes	Yes
	Nails, screws, nuts, bolts, rivets & the like, of metal	No	No	No	Yes	No
	Mineral manufactures, n.e.s.	No	Yes	No	No	Yes
	Polyethers, epoxide resins; polycarbonat., polyesters	No	Yes	No	Yes	No
	Plates, sheets, films, foil & strip, of plastics	No	No	No	Yes	No
	Lime, cement, fabrica. constr. mat. (excluding glass, clay)	Yes	No	No	Yes	Yes
Timber Products	Wood manufacture, n.e.s.	Yes	No	No	No	Yes
	Veneers, plywood, and other wood, worked, n.e.s.	Yes	Yes	No	Yes	Yes
Others	Pottery	No	No	No	Yes	No
	Baby carriages, toys, games & sporting goods	No	No	No	No	Yes
	Travel goods, handbags & similar containers	No	No	Yes	No	Yes
	Motorcycles & cycles	Yes	No	No	Yes	Yes
	Sanitary, plumbing, heating fixtures, fittings, n.e.s.	No	No	No	Yes	No
	Wire products (excluding electrical) and fencing grills	No	No	No	Yes	Yes
	Prefabricated buildings	No	No	No	No	Yes
	Ships, boats & floating structures	No	No	Yes	No	No
	Floor coverings, etc.	No	No	No	No	Yes
	Explosives and pyrotechnic products	No	No	Yes	No	No
	Appliances for pipes, boiler shells, tanks, vats, etc.	No	No	Yes	No	No
	Optical goods, n.e.s.	No	No	Yes	Yes	No
	Synth. organic colouring matter & colouring lakes	Yes	No	No	Yes	No

Source: UN Comtrade, as of December 31, 2023.

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